Section 2. Monetary and fiscal policy

2.1. Monetary policy[1]

2.1.1. Monetary policy trends

Russia's central bank adopted a new monetary policy regime in 2018 by raising the key interest rate for the first time since December 2014. After slashing the key interest rate on February 9th and on March 23rd by 0.25 percentage points to 7.5 and 7.25 percent per annum, respectively, the central bank lifted the rate on September 14th by 0.25 percentage points to 7.5 percent per annum, with another hike on December 14th of 0.25 percentage points to 7.75 percent per annum.

The transition to a neutral monetary policy regime[2] slowed as far back as in 2017. There were more constraints to interest rate cuts in 2018 that came from new April and August anti-Russia sanctions that spurred capital outflows from the country and depreciation of the Russian ruble, a VAT hike decision scheduled for 2019, a late-year fall in energy prices, and concerns about possible heightening of inflation expectations. The key interest rate hike suggested that the Bank of Russia is committed to bring inflation back down to target in the medium term. For instance, according to a forecast of the central bank, end-of-year inflation for 2019 may reach 5–5.5 percent, and it is not until 2020 that inflation is back to its target.

Another important decision the central bank took in August 2018 besides changes in the monetary policy was a decision to suspend until January 2019 its sales of rubles in the domestic foreign exchange market to purchase foreign exchange for Russia's Finance Ministry in order to comply with the fiscal rule in effect. The goal of the policy was to reduce volatility in financial markets. Amid unfavorable external environment currency interventions could indeed constitute an extra source of pressure on the Russian ruble and spur growth in exchange rate volatility. Decision on the suspended in 2018

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[1] This section was written by A. Bozhechkova, Gaidar Institute, RANEPA; A. Kiyutsevskaya, Gaidar Institute; A. Knobel, Gaidar Institute, RANEPA, VAVT; P. Trunin, Gaidar Institute, RANEPA.

[2] A neutral monetary policy means setting a key interest rate that is suitable for achieving a target inflation rate and a zero output gap. A neutral level of interest rate has neither stimulating nor restraining effect on real economy.

foreign currency purchases in the domestic market will be adopted as soon as they are resumed on a regular basis in January 2019. The suspended foreign currency purchases can be brought into effect, as planned by the central bank, in 2019 and beyond.

Credit terms remained relatively tight despite some surge in inflation and inflation expectations in 2018. For instance, there were months when the real interest rate on corporate loans with maturities less one year that is calculated using actual inflation rate over past 12 months was equal to levels seen late in 2014/early in 2015 (see *Fig. 1*). Maintaining a positive real interest rate in the money market dampens growth in consumption and investment, putting downward pressure on inflation, as well as keeps savings attractive, while posing downturn risks for the economy.

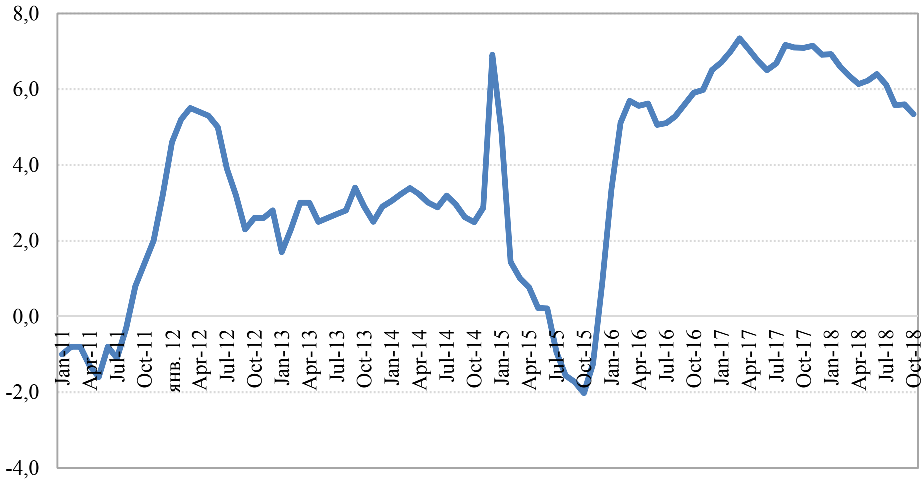


Fig. 1. Real interest rate on corporate loans with maturities of less than one year in Russia, 2011–2018, percent per annum[1]

In 2018, the real rate of interest under the monetary policy in place remained one of the highest in the world (see *Fig. 2* and *Table 1*). The 2018 year-end key interest rate stood at 3.5 percentage points above inflation.

Table 1

Inflation and key interest rate in developed and developing countries (2018 year end)*

	Actual rate of inflation	Key interest rate
1	2	3
Developing countries		
Poland	1.19	1.5
Peru	2.19	2.75
India	2.19	6.5
Chile	2.57	2.75
Hungary	2.71	0.9
Indonesia	3.13	6

[1] Real interest rate is measured using inflation data for the previous 12 months, assuming that inflation expectations in Russia are adaptive.

Cont'd

1	2	3
Columbia	3.18	4.25
Brazil	3.75	6.5
Russia	**4.27**	**7.75**
South Africa	4.4	6.75
Mexico	4.83	8.25
Kazakhstan	5.3	9.25
Turkey	20.3	24
Developed countries		
E.U.	1.6	0
Australia	1.8	1.5
New Zealand	1.9	1.75
U.S.A.	1.91	2.5
Canada	1.99	1.75
U.K.	2	0.75
Czech Republic	2.02	1.75
Norway	3.49	0.75
Iceland	3.74	4.5

* Data for 2018 inflation are defined on a December to December basis, data for 2018 key interest rate are defined on a year-end basis.
Source: data from central banks' official websites.

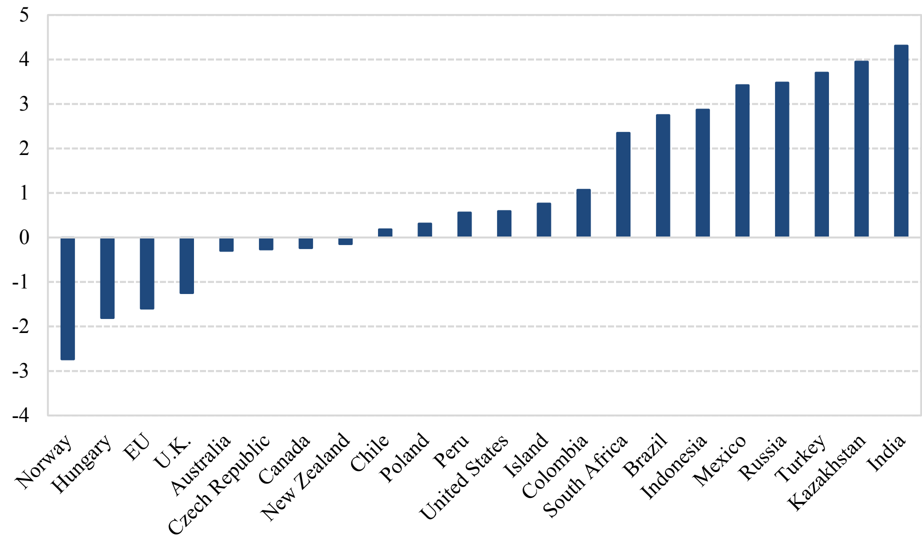


Fig. 2. Real key interest rate as of end-October 2018, percent per annum (measured on the basis of inflation rate over previous 12 months)

Sources: data from central banks' official websites, own calculations.

Thus, faced with old and new extra risks of inflation, as noted above, the Bank of Russia has not yet been able to move to a softer monetary policy. It is not until inflation is at its highest projected for mid-2019 that the Bank of Russian is expected to cut the key interest rate. That said, the emergence of new risks may even further set back efforts to move to a monetary policy easing.

2.1.2. Money market

The money market in 2018 continued to operate against a backdrop of banking sector liquidity structural surplus[1] that emerged as far back as in 2017 as a result of liquidity creation through spending from sovereign wealth funds as well as Bank of Russia's rescue policies applied to a few banks. It is against this background that the Bank of Russia introduced polices directed towards providing less liquidity to banks and broadening liquidity absorption. The liquidity surplus increased in 2017 from – RUB 0.7 trillion to RUB 2.6 trillion, with a RUB 4.5 trillion rise in January/first half of August 2018. The liquidity structural surplus started declining since the second half of August to reach RUB 2.7 trillion by the end of December as a result of Bank of Russia's decision to suspend until late in the year buying foreign currency in the domestic foreign exchange market in conformity with the fiscal rule in place.

In 2018, one-week deposit auctions were one of the most sought-after monetary policy instruments amid liquidity surplus in the banking sector. An average of RUB 2.6 trillion were raised in 2018, whereas the 2017 fundraising was RUB 1.0 trillion or less. The Bank of Russia also increased the frequency of deposit auctions "fine tuning" so that interest rates in the money market are close to the key interest rate.

In 2018, the central bank increased the placement of Bank of Russia coupon bonds (coupon OBRs) with 3 months to maturity. Outstanding coupon OBRs in 2018 rose from RUB 0.4 trillion to RUB 1.4 trillion, hitting highs in October 2018 (RUB 1.8 trillion). As a reminder, the Bank of Russia started issuing coupon OBRs in August 2017. According to our estimates, coupon OBRs helped absorb around one third of the amount that would have been accumulated by the banking sector if absorbing operations had not been in place.

Note that the Bank of Russia projects that the banking sector will continue to experience liquidity surplus for three years to come. Amid structural liquidity surplus in 2018 credit institutions increased their liabilities to the Bank of Russia. The 2018 year-end amount of loans, deposits and other funds raised by credit institutions were up 29.3 percent to RUB 2.6 trillion (compared to a 4-fold decline to RUB 2.0 trillion in 2017) (see *Fig. 3, Table 2*). It appears that credit institutions' liabilities to the central bank is due to the fact that liquidity surplus that is identified at the macro-level is not typical of each bank taken separately. In this context, banks that are faced with liquidity deficit show demand for central bank funding.

In 2018, loans secured with non-marketable assets (RUB 403 billion on average) prevailed in the structure of central bank's claims on the banking sector, while banks' liabilities on REPO auctions in the same period averaged as little as RUB 4.5 billion.

[1] The structural surplus is described as stable liquidity surplus at credit institutions and the necessity for the Bank of Russia to carry out liquidity-absorbing operations with the aim to maintain interest rates in the interbank lending market close to the key interest rate.

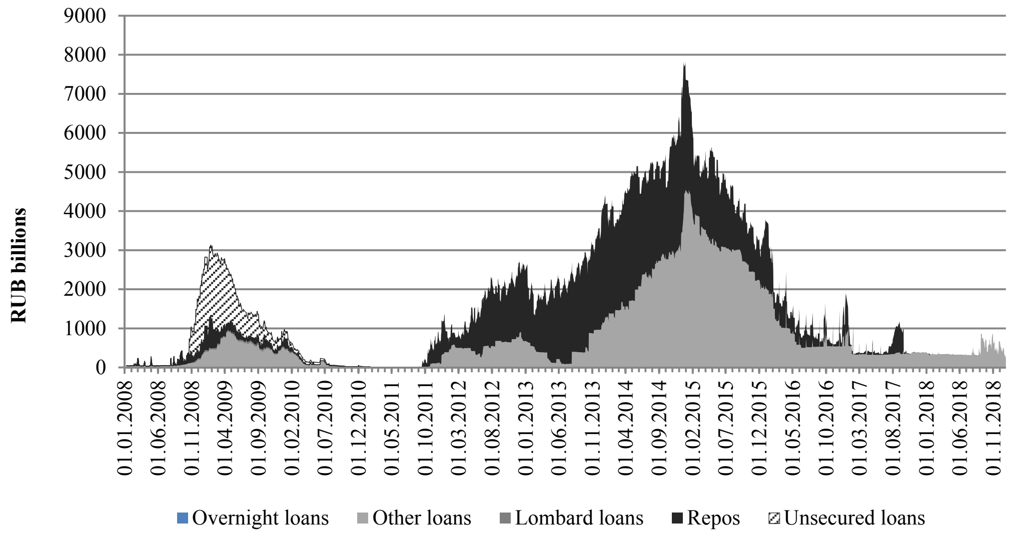


Fig. 3. Commercial banks' ruble-denominated liabilities (on key instruments) to Bank of Russia in 2008–2018

Source: Bank of Russia.

Table 2

Bank of Russia Balance Sheet 2016–2018

	January 1, 2017		January 1, 2018		December 1, 2018	
	RUB billions	**as a percent of assets / liabilities**	**RUB billions**	**as a percent of assets / liabilities**	**RUB billions**	**as a percent of assets / liabilities**
Funds placed with nonresidents and securities issued by nonresidents	18.005.1	62.1	18878.5	61.3	23242.1	61.6
Credits and deposits	4.175.1	14.4	3517. 8	11.4	3928.2	10.4
Precious metals	3.747.5	12.9	4505.2	14.6	5594.5	14.8
Securities	528.9	1.8	886.1	2.9	948.2	2.5
Other assets	1.013.4	3.5	1535.7	5.0	2316.8	6.1
Total assets	**28.974.1**	100.0	**30.815.1**	100.0	**37.702.3**	100
Cash in circulation	8.790.1	30.3	9539.4	31.0	9788.9	26.0
Balance of accounts with the Bank of Russia	9.985.5	34.5	11003.2	35.7	14698.5	39.0
of which: Russian government funds	4.662.0	16.1	4565.7	14.8	8477.6	22.5
funds of resident credit institutions	3.093.3	10.7	4812.4	15.6	4294.9	11.4
Float	2.8	0.0	0.7	0.0	1.4	0.0
Outstanding securities	-	-	356.8	1.2	1636.7	4.3
Liabilities to IMF	1.392.9	4.8	1.407.8	4.6	1537.8	4.1
Other liabilities	111.4	0.4	120.8	0.4	1653.3	4.4
Capital	8.647.85	29.8	8.386.5	27.2	8385.7	22.2
Profit for accounting FY	43.7	-	-	-	-	-
Total liabilities	**28.974. 1**	100	**30.815.1**	100.0	**37.702.3**	100

Source: Bank of Russia.

Amid structural liquidity surplus the money market interest rate in 2018 varied mostly within a lower boundary of the interest rate band. The interbank loan rate[1] increased in 2018 0.4 percentage points (from 7.1 percent per annum on average in January 2018 to 7.5 percent per annum on average in December 2018). The MIACR in April-August 2018 was at its lowest (7.0 percent) since late in 2014. The MIACR started moving upwards after the central bank decided to raise the key interest rate by 0.25 percentage points. Overall, the interbank loan rate varied during 2018 within the interest rate band set by the central bank, thus suggesting that the regulator achieved the goal of its monetary policy. The average annual MIACR on overnight bank loans denominated in Russian rubles fell to 7.1 percent per annum in 2018 from 8.9 percent per annum in 2017 (see *Fig. 4*).

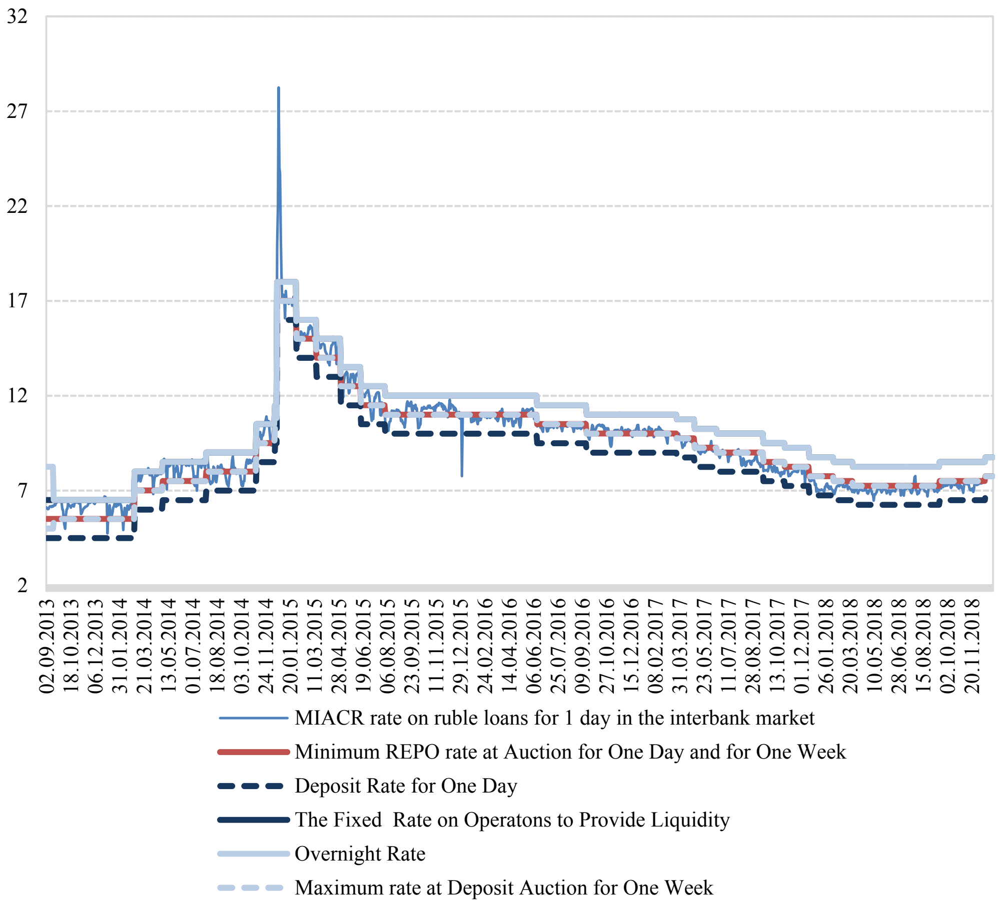


Fig. 4. Bank of Russia's interest rate band and dynamics of interbank lending market in 2013–2018

Sources: Bank of Russia, Gaidar Institute's calculations.

[1] The interbank loan rate is the monthly average MIACR (Moscow InterBank Actual Credit Rate) on overnight interbank loans denominated in Russian rubles.

The accumulation of liquidity surplus in the banking sector influenced the dynamics of the monetary base. The broad monetary base picked up 9.3 percent to RUB 16063.4 billion in 2018 (an increase of 23.7 percent to RUB 14701.5 billion in 2017). Bank of Russia bonds held by credit institutions was one of the broad monetary base components with fastest pace of growth at 2018 year-end that saw a quadruple growth to RUB 1373.9 billion. The required reserves swelled by 13.6 percent to RUB 575.3 billion, cash in circulation advanced 8.1 percent to RUB 10312.5 billion. Banks' deposits with the Bank of Russia dropped 19.8 percent to RUB 1903.5 billion, corresponding accounts slid 1.7 percent to RUB 1898.2 billion. Overall, excessive reserves[1] increased in 2018 by 11.2 percent to RUB 5175.7 billion (see *Table 3*).

Table 3

Broad monetary base dynamics of 2018 (RUB billions)

	April 01, 2017	January 07, 2017	January 07, 2017	January 01, 2018	January 01, 2019
Monetary base (broad definition)	11543.5	11596.4	12916.2	14701.5	16063.4
- cash in circulation including cash in vaults of credit institutions	8394.9	8752.7	8895.1	9539.0	10312.5
- correspondent accounts of credit institutions with the Bank of Russia	2143.9	1675.3	2225.0	1930.7	1898.2
- required reserves	510.5	509.7	536.7	506.2	575.3
- deposits of credit institutions with the Bank of Russia	494.2	658.6	1109.8	2373.2	1903.5
- Bank of Russia's bonds held by credit institutions	0	0	149.7	352.4	1373.9
For reference: excessive reserves	2638.1	2333.9	3484.5	4656.3	5175.7

Source: Bank of Russia.

Like in the 2015–2017 period, the principal sources of accumulation of the broad monetary base in January-November 2018 were changes in the balance on the general government's accounts with the central bank as well as Bank of Russia's liquidity-providing/absorbing operations in the banking sector. For instance, RUB 0.3 trillion were added to the monetary base through increasing central government's net borrowing in January-November 2018, whereas the monetary base shrank by RUB 0.2 trillion as a result of decrease in net volumes of liquidity-providing/absorbing operations. Amid structural liquidity surplus the structure of money supply creation will likely remain unchanged in 2019 as well. Note that operations that the Finance Ministry and the central bank performed in compliance with the fiscal rule were neutral for the monetary policy (see *Fig. 5*). The money the Finance Ministry uses for increasing the National Wealth Fund is brought back to the economy as a result of Bank of Russia's foreign currency purchases.

[1] Excessive reserves of the banking system comprise credit institutions' deposits and correspondent accounts with the Bank of Russia as well as Bank of Russia bonds held by credit institutions.

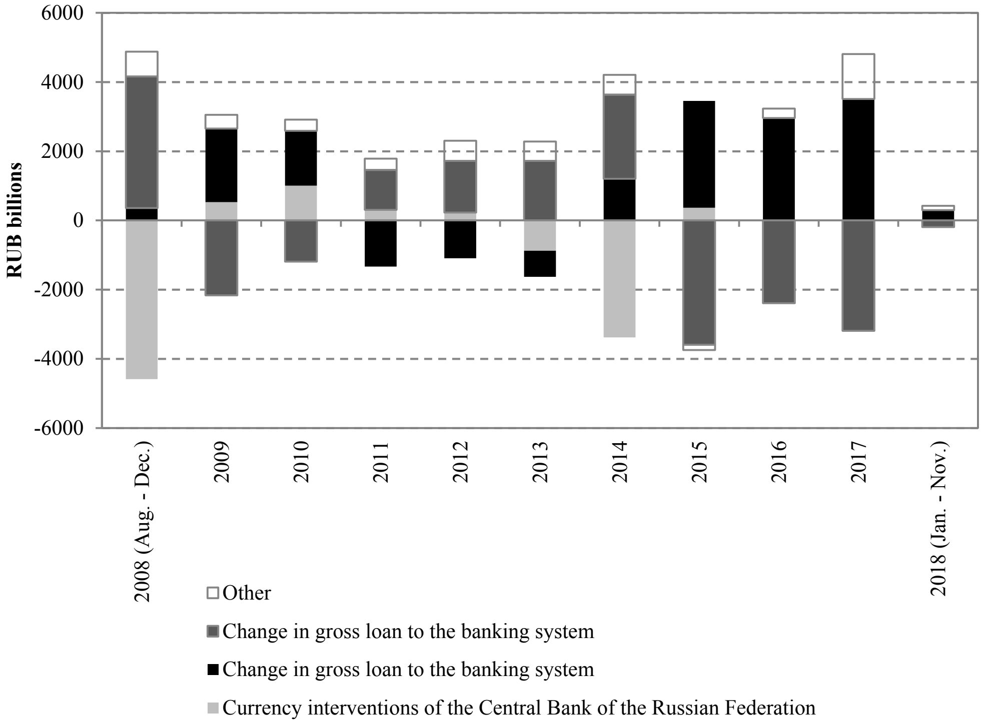


Fig. 5. Factors that influence monetary base

Source: Russia's central bank.

The dynamics of foreign currency reserves in 2018 was almost totally led by volumes of Bank of Russia's foreign currency purchases for the Finance Ministry in conformity with the fiscal rule in place. As a reminder, under the new fiscal rule in effect since early in 2018, extra federal budget revenues that come from a crude oil price that is higher than the actual price of USD 40.8 per barrel shall be converted into foreign currency to feed into the sovereign wealth fund. Such operations, as noted above, were carried out until they were suspended in the second half of August 2018 due to unstable financial markets. In January-August 2018, central bank's foreign currency purchases in the domestic foreign exchange market totaled around RUB 2.1 trillion. As a result, Bank of Russia's year-end international reserves increased USD 35.8 billion (8.3 percent) to USD 468.5 billion as of January 01, 2019 (see *Fig. 6)*. Note that USD 10.3 billion (13.4 percent) were added to the monetary gold reserves on a year to date basis in 2018 despite of their negative revaluation (-USD 10.1 billion) in January-August 2018 due to falling gold prices in global markets. As of January 01, 2019, the proportion of foreign currency reserves accounted for 81.5 percent (82.3 percent in 2017) as gold represented 18.5 percent (17.7 percent in 2017) of gross reserve assets. At present, the reserves are adequate to ensure a stable balance of payments because they cover both 16 months for imports of goods and services in Russia (16 months in 2017) and external debt payments due in 2019. An important point to note is that 2018 saw a major change in the foreign-currency reserves composition: the proportion of Yuan-denominated assets advanced from 0.1 percent in mid-2017 to 14.7 percent in mid-2018, whereas the proportion of assets denominated in US dollars dropped from 46.3 percent in mid-2017 to 21.9 percent in mid-2018. The above change was likely led by the need to minimize potential geopolitical risks. Furthermore, the monetary authorities had to sacrifice dollar-denominated returns on investment because of problems facing China's economy in 2018. The Chinese Yuan weakened against the US dollar.

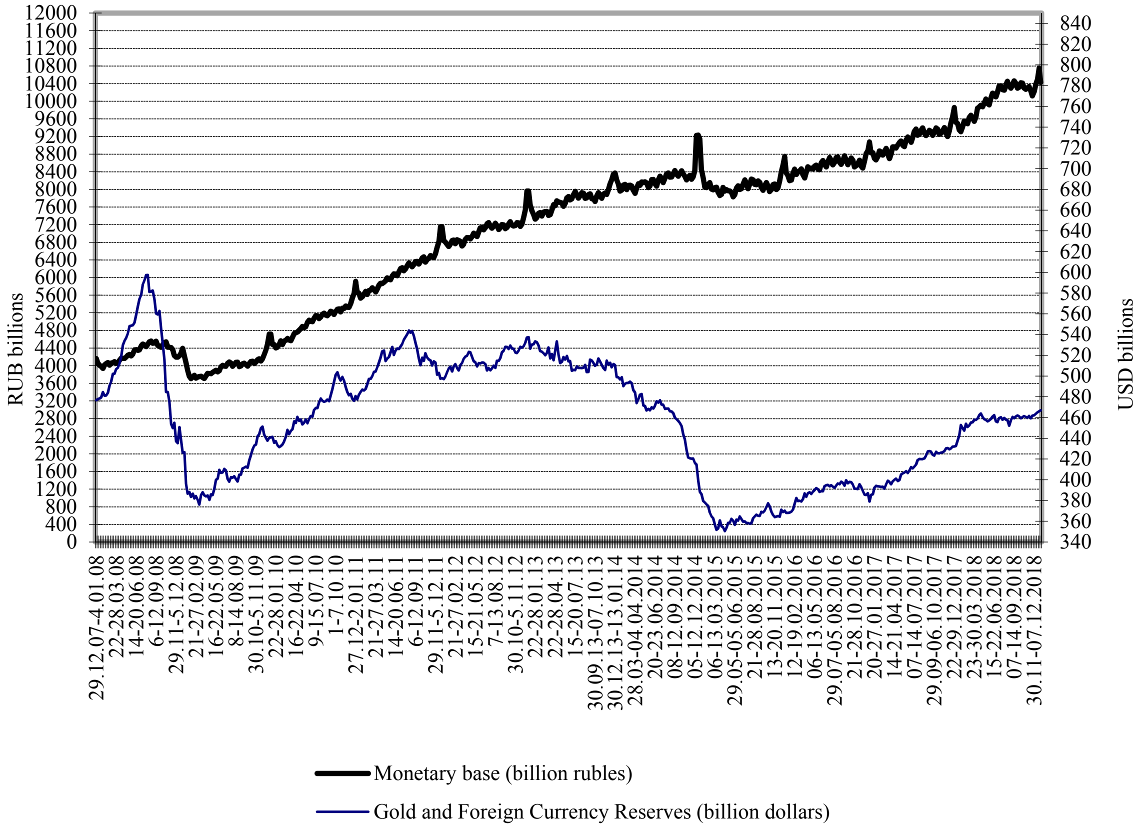


Fig. 6. Dynamics of narrow monetary base and Russia's foreign currency and gold reserves (international reserves) in 2008-2018

Source: Bank of Russia.

In 2018, the year-to-year average monthly growth in M2 and the monetary base was recorded at 11.0 percent (10.2 percent in 2017) and 29.0 percent (11.9 percent in 2017), respectively. As a result, the money multiplier (the ratio of M2 to the monetary base) stood at 2.8 (3.3 in 2016–2017). Such a sharp contraction of the money multiplier was due to faster than normal growth rates in the monetary base spurred by a 4-fold increase in volumes of Bank of Russia bonds held by credit institutions as well as increase in banks' deposits with the central bank (average monthly growth in banks' deposits with the Bank of Russia in 2018 saw a 2.5-fold average monthly growth) in order to absorb liquidity surplus in the banking sector and to maintain market interest rates within a prescribed boundary of the interest rate band. The money multiplier equals the average for emerging economies (such as Ukraine, Belarus, Kazakhstan), whereas it tends to vary within a range of 5–8 in developed countries. Note that East European countries saw their money multiplier rise over the past two decades as their banking system advanced further. In Poland, for example, the money multiplier advanced to 5.8 from 3.1 in the 1993–2018 period, whereas in Russia it was up to 2.75 from 1.4, hitting its highest in 2015–2016.

According to preliminary estimates, the level of monetization of the Russian economy (the ratio of broad money (M2) to GDP (the M2/GDP ratio)) in the period between 1999 and 2018 tripled to 60.1 percent in 2018, almost reaching the ratio seen in Central and East European countries that are traditionally characterized by higher degree of monetization. In Poland, for example, the M2/GDP ratio in 2017 stood at 66.8 percent (40.2 percent in 1999). By contrast, the M2/GDP ratio in Belarus increased during the same period by 2.3 times to 37.9 percent, by 2.9 times to 37.4 percent in Kazakhstan, and by 2.2 times to 40.5 percent in Ukraine. Developed countries had even higher GDP monetization owing to a more advanced financial system: in 2017, for example, the M2/GDP ratio in the U.K. and Switzerland reached 148.5 and 190 percent, respectively.

2.1.3. Inflation-related processes

After hitting an all-time high of 2.2 percent in January 2018, there was a gradual rise in inflation during the year (see *Table 4*). While the first half of the year saw inflation vary within a range of 2.2–2.5 percent, the second half marked an inflationary spike that was triggered by increase in prices for some groups of food products due to poor crop figures, depreciation of the Russian ruble, and expected VAT rate hike. By the end of November 2018, inflation reached 3.8 percent year-to-year (percentage change over previous 12 months) (versus 2.5 percent at 2017 year-end) (see *Fig. 7*).

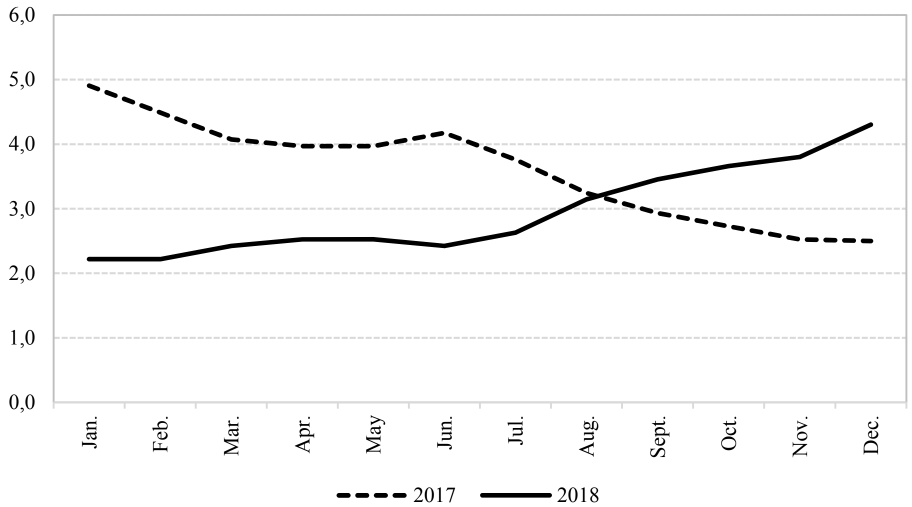


Fig. 7. CPI growth rate in 2016–2018, percentage change over past 12 months

Sources: Rosstat; own calculations.

Table 4

Annual growth rate of prices for selected consumer goods and services in 2015–2018, Dec.-to-Dec. percent change

	2016	2017	2018	2016–2018
CPI	**5.4**	**2.5**	**4.3**	12.7
Food products	**4.6**	**1.1**	**4.7**	10.7
Butter	20.5	9.6	3.6	36.8
Fish and seafood	8.6	3.8	3.7	16.9
Sunflower oil	3.4	-8.6	1.8	-3.8
Milk and dairy products	9.5	5.2	2.9	18.5
Macaroni, noodles and similar farinaceous products	4.5	-0.7	1.4	5.2
Bread and bakery products	5.9	2.7	5.2	14.4
Alcoholic beverages	6.4	2.9	1.3	10.9
Fresh fruits and vegetables	-6.8	1.2	4.9	-1.1
Cereals and legumes	6.4	-13	1.2	-6.3
Meat and poultry	1.6	-2.3	9.7	8.9
Eggs	-0.7	-14.2	25.9	7.3
Nonfood products	**6.5**	**2.8**	**4.1**	14.0
Motor gasoline	3.8	7.3	9.4	21.8
Tobacco products	17.8	8.6	10.1	40.9
Textiles	7.6	3.7	1.7	13.5
Washing and cleaning agents	6.3	0.6	3.1	10.3
Footwear	9.2	4	1.9	15.7
Textile goods	7.5	3.3	2.5	13.8
Clothing and underwear	7.3	3	2.3	13.1
Medicines	4.9	-3.4	4.6	6.0
Services	**4.9**	**4.4**	**3.9**	13.8
Early childhood educational services	9.3	5.2	3.8	19.4
Passenger transport services	6.6	6.8	4.3	18.7
Medical services	7.8	5	4.3	18.1
Educational services	4.9	7.5	8.4	22.2
Utility services	5.4	4.6	3.7	14.3
Communication services	3.7	4.7	2.4	11.2

Source: Rosstat.

There was a 4.7 percent acceleration in food prices in January-December 2018 versus 1.1 percent in 2017 (see *Fig. 8*). Note that in July-September 2018 the food sector experienced a deflation (-1 percent in July, -1.8 percent in August, -0.7 percent in September) that was driven by decline in prices of fresh fruits and vegetables on the back of good crop figures (-5.1 percent in July, -6.4 percent in August, -6.8 percent in September). Inflation acceleration in the food sector in September-December 2018 was due to a 40.3 percent price rise for eggs and 13.8 percent for sugar sand as well as gradually increasing meat and poultry prices during 2018 (9.7 percent up in January-December 2018).

Non-food prices in 2018 picked up 4.3 percent (2.5 percent in 2017). The following products saw most of the price acceleration in January-December 2018: motor gasoline (up 9.4 percent), tobacco products (up 10.1 percent), construction materials (up 4.9 percent) and brown goods and other household appliances (up 3.7 percent). Note that the surge in motor gasoline prices in April-June 2018 stemmed from high crude prices and the April slump in the Russian ruble exchange rate amid tighter anti-Russia sanctions. Overall, the 2018 appreciation of some groups of nonfood products was in a large part due to the effect of ruble exchange rate depreciation pass-through to prices. What is important to note is that, according to Bank of Russia's estimates, the effect of exchange rate pass-through to prices in 2018 declined to around 0.1, suggesting that the 8.2 percent weakening in the ruble nominal effective exchange rate in January-December 2018 would add 0.82 percentage points to the annual inflation over the immediate 3–6 month horizon.

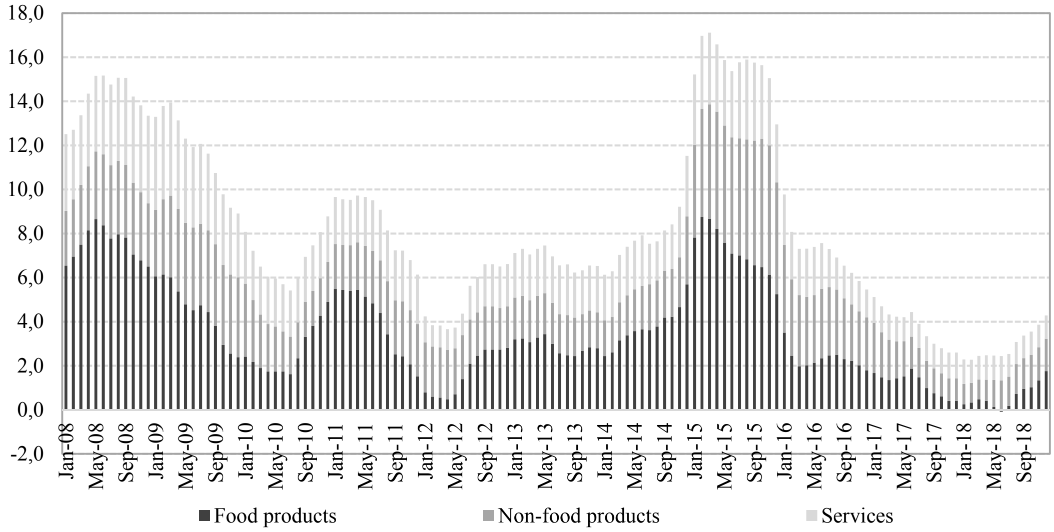


Fig. 8. Inflation structure in 2008–2018, percent change from previous year's month

Sources: Rosstat; own calculations.

Chargeable services to individuals increased 3.9 percent in 2018 (compared to a 4.4 percent rise in 2017). Overall, in January-December 2018, the highest increase in prices due to the ruble depreciation was seen for outbound tourism services (up 9.8 percent).

The 2018 year-end core inflation (an indicator excluding changes linked to seasonal and administrative factors) reached 3.7 percent (versus 2.1 percent in 2017). Note that the core inflation is on the rise since March 2018, thus suggesting that the country is faced with a steady acceleration of inflation.

Individuals' inflation expectations in 2018 followed the actual inflation trajectory. The median one-year ahead expected inflation rate reached 10.2 percent in December 2018 after April's lows (7.8 percent), according to InFOM's survey published by the Bank of Russia (see *Fig. 9*). Not only inflation expectations but also respondents' assessment of actual inflation rate (10.2 percent) remained at high levels. The onset of the 2018 reversal trend in inflation expectations and high risks of their further increase amid plans to raise early in 2019 the VAT and the motor gasoline excise tax became important factors prompting the Bank of Russia to lift the key interest rate.

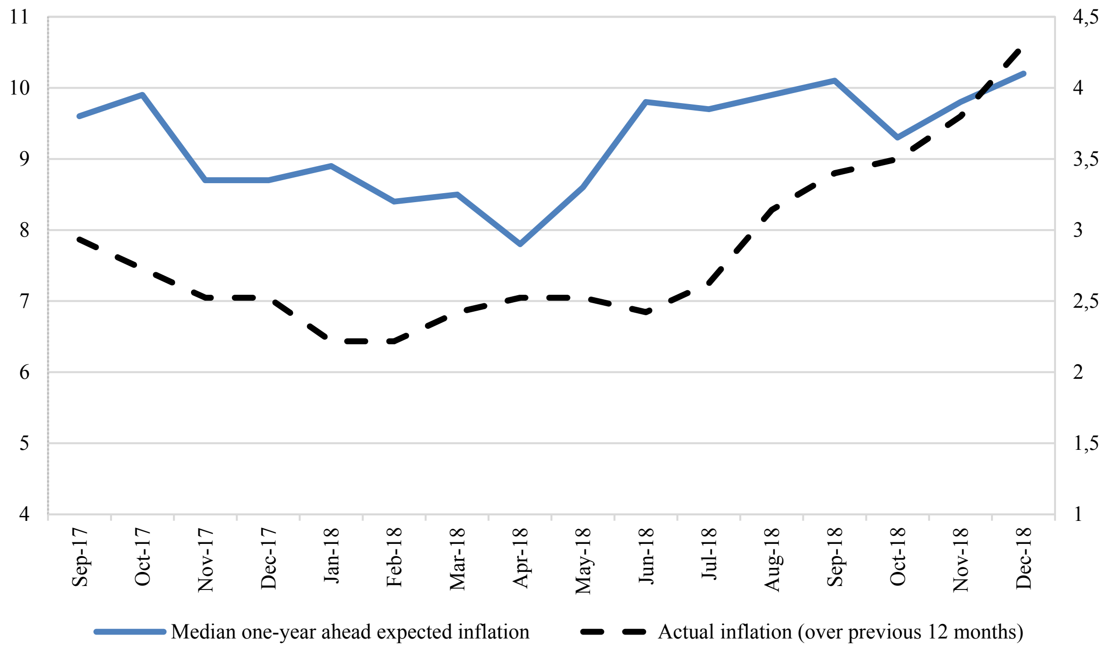


Fig. 9. Inflation and inflation expectations

Sources: Rosstat, Bank of Russia.

The ruble exchange rate dynamics remains a significant source of inflationary risks. For instance, depreciation of the Russian ruble remains a key driver of inflation at a backdrop of tighter sanction rhetoric in April and August 2018 as well as accelerated capital outflows from emerging markets due to the U.S. Fed's tighter monetary policy.

Below we finally compare Russia's consumer price growth rates with those of other countries (see *Table 5*).

Table 5

Consumer price index dynamics of various countries in 2015–2018, percent a year

	2016	2017	2018	2016–2018
Azerbaijan	15.7	12.9	2.3	33.6
Armenia	-1.1	2.6	1.8	3.3
Belarus	10.6	4.6	5.6	22.2
Kazakhstan	8.5	7.3	5.3	22.6
Kyrgyzstan	-0.5	3.7	0.5	3.7
Moldova	2.4	7.3	0.9	10.9
Russian Federation	*5.4*	*2.5*	*4.3*	*12.7*
Tajikistan	6.1	6.7	5.4	19.3
Ukraine	12.4	13.7	9.8	40.3
Germany	0.5	1.7	1.7	3.9
France	0.2	1.2	1.6	3.0
United States	1.3	2.1	1.9	5.4
The Netherlands	0.3	1.3	2.0	3.6

Sources: Interstate Statistical Committee of the Commonwealth of Independent States (http://www.cisstat.com/), OECD database.

At the end of 2018, the Russian Federation ranked in the middle of the list of CIS countries in terms of consumer price growth rates. Two CIS countries – Ukraine and Belarus – posted highest rates of inflation of 9.8 and 5.6 percent, respectively (see *Table 5*). Note that while the 2016 inflation rate in Russia averaged 16 times the inflation rate in developed countries, Russia in 2017 had consumer price growth rates comparable with developed countries (2.6 percent in the United States, 2.3 percent in The Netherlands).

Thus, the Bank of Russia managed in 2015–2017 to lower drastically the inflation rate and to adopt a stepwise monetary policy easing. However, new high risks that emerged in 2018 prompted two cuts in the key interest rate by a total of 0.5 percentage points. Inflation may reach 5–5.5 percent at the end of 2019, and it is not until 2020 that inflation can be brought back down to its target rate, according to central bank's estimates. It is therefore not until the second part of 2019 that Bank of Russia will be able to cut the key interest rate.

2.1.4. Balance of payments and ruble exchange rate

In 2018, Russia posted the highest on record positive current account balance since 1992, according to BoP data for 2018. At the same time, the private sector saw substantial capital outflows that were driven by reduced foreign liabilities and increased foreign assets for banks and enterprises.

According to preliminary data on the Balance of Payments 2018 from the Bank of Russia, Russia's current account balance was recorded at USD 114.9 billion, or 2.5 times (an increase of USD 81.6 billion) the amount recorded in the preliminary data for 2017[1]. In absolute terms, the country saw its current account balance hit its highest on record since 1992. As a percentage of GDP, however, the current account balance was even higher in the period between 2001 and 2006.

The balance of trade in goods amounted to USD 194.4 billion, posting an increase of 68 percent (adding USD 79 billion in absolute terms) over the amount recorded in 2017 (USD 115.4 billion) (*Fig. 10*). The pivotal contribution came from a 25 percent rise in exports (adding USD 90 billion in absolute terms) from USD 353.5 billion in 2017 to USD 443.4 billion in 2018. The growth was mostly due to increase in the annual average price of crude oil, petroleum refined products and natural gas as well as other Russia's primary export commodities amid stable physical volumes of exports (see *Table 6, Fig. 11*).

[1] See A. Bojechkova, A. Knobel, P. Trunin. Russia's Balance of Payments 2017 // Russian Economic Developments. 2018. Vol. 25. No 2. PP. 8–11.

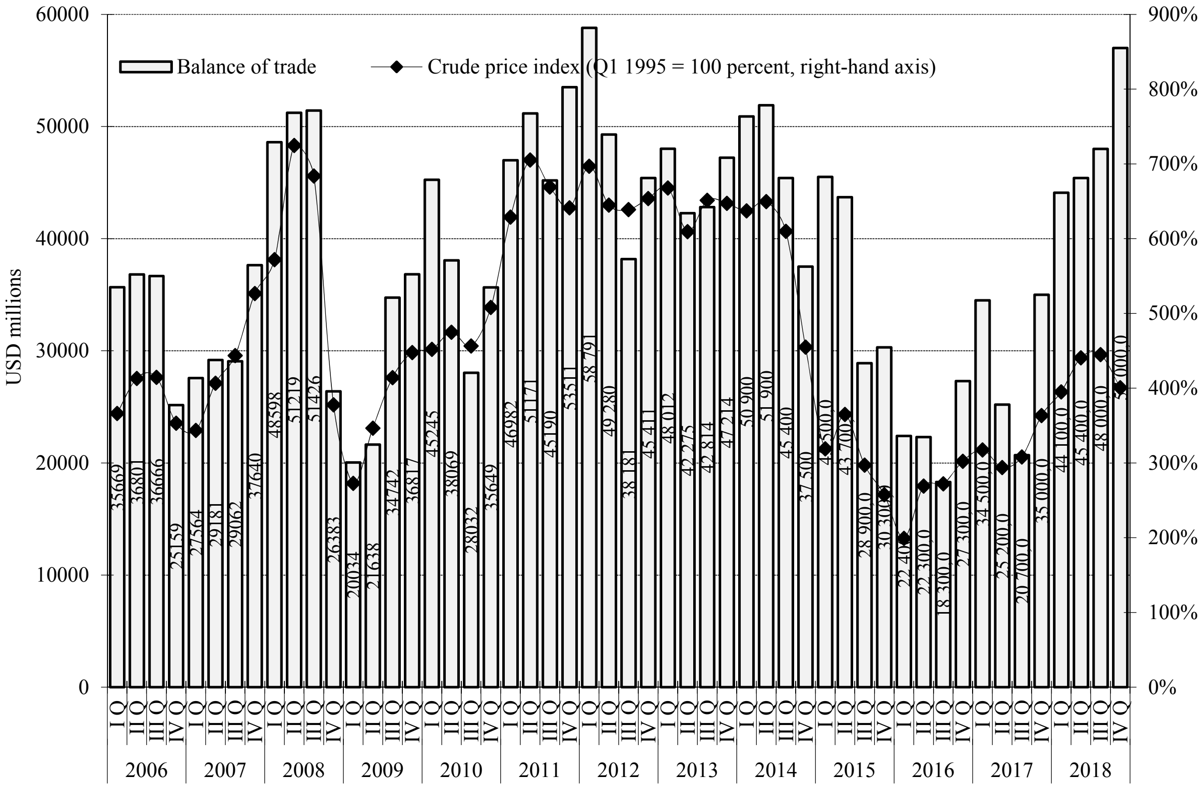


Fig. 10. Russia's balance of trade and oil price dynamics

Sources: Bank of Russia, IMF.

Table 6

Prices of Russia's principal export commodities in 2018 compared to 2017

Commodity	Commodity's share of exports, percent	Average export price in January-November 2018 (USD thousands / tonne)	Average export price in January-November 2017 (USD thousands / tonne)	Gains in prices, percent
Crude oil	29	501	365	37
Refined petroleum products	18	521	388	34
Natural gas*	11	221	180	23
Ferrous metals	5.2	506	440	15
Hard coal	3.8	85	75	14
Wheat and meslin	1.9	190	176	8
Fertilizers	1.7	237	209	14
Liquefied natural gas (LNG)**	1.2	142	131	9
Aluminum	1.2	1.757	1.646	7
Sawn timber	1.0	234	217	8
Copper	0.9	6.355	6.133	4
Fresh and frozen fish	0.7	1.822	1.587	15
Nickel	0.4	13.058	10.044	30

* – for billion cubic meters
** – for thousand cubic meters
Sources: Russia's Federal Customs Service, own calculations.

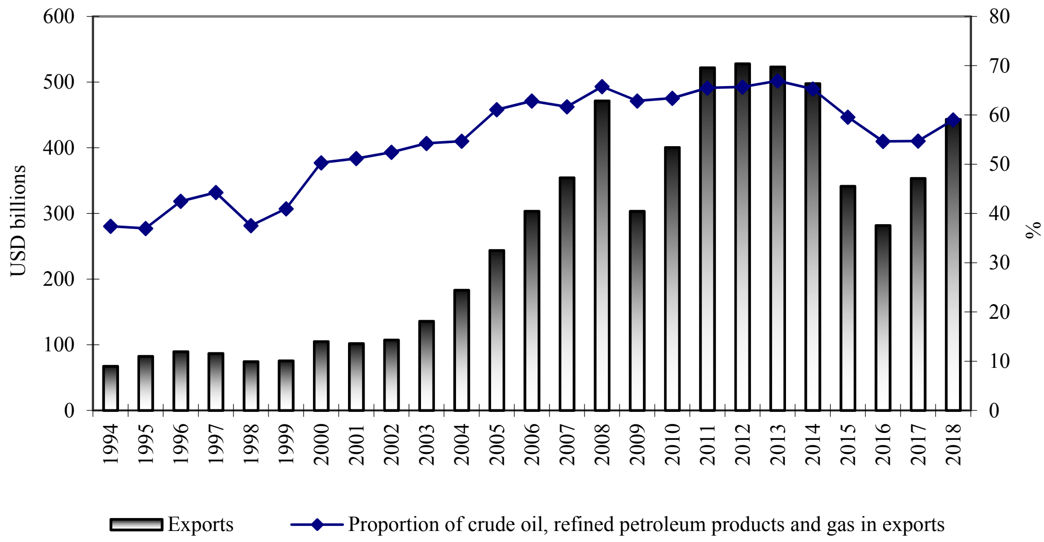


Fig. 11. Dynamics of exports of goods and proportion of fuel and energy sector products in 1994–2018

Source: Bank of Russia.

The growth in the balance of trade in goods was also due stagnant imports with a growth of 4.6 percent (the growth in absolute terms was USD 11 billion) to USD 249 billion in 2018 from USD 238 billion in 2017. However, the second half of the year saw imports drop 2.3 percent (or USD 3 billion) compared to H2 2017. The decline was in most part due to a weakening ruble: according to data from the Bank of Russia, the index for the ruble's real effective exchange rate against foreign currencies lost 7.7 percent in 2018 compared to 2017 – a substantial decline indicating a relative appreciation of imports[1].

Russia's balance of trade in services in 2018 amounted to -USD 30.2 billion, or 2.9 percent in absolute terms less than the amount (-USD 31.1 billion) recorded in 2017. In 2018, exports of services increased from 2017 (mainly due to inbound tourism to Russia and transport services) and imports of services rose (due in large part to travels, transport and other business services). Furthermore, exports saw a bigger rise in both relative and absolute terms that first of all was due to the FIFA World Cup 2018 hosted by Russia. Exports saw an annual rise of 13 percent from USD 57.7 billion to USD 65 billion as imports were up 7.5 percent from USD 88.8 billion to USD 95.5 billion.

The investment income balance and the *compensation of employees balance* underwent minor changes in 2018. The former was up USD 0.9 billion (from -USD 39.8 billion to -USD 38.9 billion) as the latter increased USD 0.5 billion (from -USD 2.3 billion to -USD 1.8 billion).

[1] For more details on the exchange rate influence on trade see A. Knobel, A. Firanchuk, Russia's foreign trade in January-August 2017 // Economic Development of Russia. 2017. Vol. 24. No. 11, pp. 12–18.

Thus, the key factor that governs the current account balance in the Russian economy still remains the same – the balance of trade in services and the balance of trade in goods which depends largely on, *firstly*, prices of hydrocarbons (energy commodities) and other Russia's primary export commodities and, *secondly*, the nominal exchange rate of the Russian ruble.

Russia's current account surplus increased alongside the rise in the financial account deficit which in 2018 was 6 times (USD 76.8 billion) the amount recorded in 2017 (USD 12.6 billion). Banks and enterprises in 2018 saw net capital outflows reach USD 67.5 billion, while in 2017 they were USD 25.2 billion (see *Fig. 2*). While in 2017 capital outflows in the private sector were almost entirely linked to banks' operations, the contribution of banks and enterprises in 2018 was comparable: USD 30.9 billion (USD 23.3 billion in 2017) and USD 36.6 billion (USD 1.9 billion in 2017), respectively.

Capital outflows in the banking sector were driven on the one hand by a USD 7.0 billion growth in foreign assets of banks (2017 saw foreign assets drop USD 4.4 billion) and on the other hand by a USD 23.9 billion reduction of foreign liabilities (foreign liabilities in 2017 were reduced by USD 27.7 billion).

Net capital outflows at enterprises were triggered mainly by a USD 30.3 billion increase in their foreign assets (an increase of USD 18.2 billion in 2017). Enterprises raised them mainly in the form of foreign direct investment (up USD 25.8 billion in 2018 from USD 35.9 billion in 2017) and other assets (up USD 13.0 billion in 2018 from -USD 11.7 billion in 2017).

In 2018, enterprises started reducing their foreign liabilities (a decline of USD 7.1 billion), whereas in 2017 they ramped them up by USD 14.2 billion. For instance, credits and loans were reduced as low as USD 9.6 billion (down by USD 8.5 billion in 2017) and portfolio investments were down USD 0.5 billion (USD 4.5 billion down in 2017). Their foreign direct investment were merely USD 1.9 billion versus USD 27.1 billion in 2017 as other liabilities reached USD 1.1 billion (USD 0.1 billion in 2017).

The OFZ bond (ruble-denominated Russian government bonds) market in 2018 was driven in large part by investors' expectations of tighter sanctions against Russia's sovereign debt. In 2018, non-residents reduced their holdings of OFZ bonds by USD 5.7 billion (compared to an increase of USD 13.6 billion in 2017). As a result, the proportion of non-residents in the OFZ market reached its highest (34.5 percent) in April 2018 and then dropped by early December 2018 to 24.7 percent.

In 2018, Russia reduced its foreign debt by USD 64.4 billion to USD 453.7 billion as of January 01, 2019. The central government's foreign debt was reduced by 20.7 percent to USD 44.1 billion on the back of, as noted above, outflows of nonresident OFZ bond holders. As a result of reduced foreign liabilities in the private sector, banks' foreign liabilities were reduced by 11.3 percent to USD 397.6 billion.

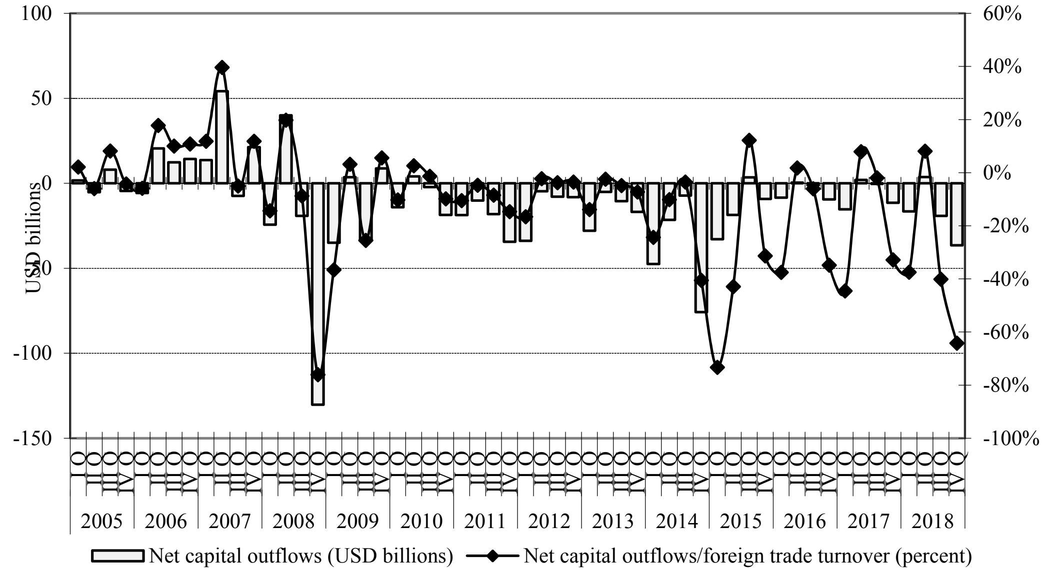


Fig. 12. Private sector's net capital outflows, 2005–2018

Sources: Bank of Russia, own calculations.

We have revised downward our capital flight estimate for 2018 year-end (*Fig. 13*) (it was estimated at USD 6.1 billion in 2017) to USD 3.3 billion[1], which reflects successful efforts of the Russian government to counteract capital outflows via illegal channels.

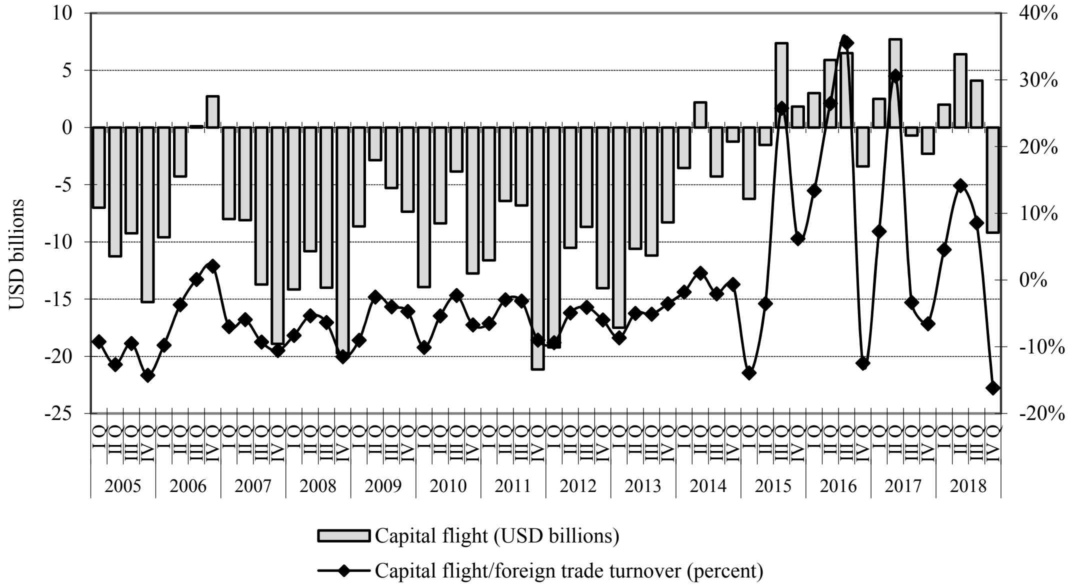


Fig. 13. Capital flight dynamics, 2005–2018

Sources: Bank of Russia; own calculations.

[1] We use the IMF method to measure capital flight, that is, the sum of "trade credits and advances", "dubious operations" and "net errors and omissions."

Substantial capital outflows from Russia in 2018 despite high prices of energy commodities led to a substantial depreciation of the Russian ruble as of 2018 year end. The ruble plummeted to its weakest in April (down 8.3 percent to 62 rubles per dollar compared to late in March) and in August (down 8.4 percent to 68.1 rubles per dollar from late July). The ruble devaluation was triggered primarily by capital outflows driven by tightened anti-Russia sanctions. In addition, the ruble in 2018 was driven by a downturn in all emerging markets as a result of the U.S. tighter monetary policy, trade wars, heightened risks of investing in emerging markets because of financial turmoil facing Argentina and Turkey.

As a result, the Russian ruble in nominal terms lost in 2018 by an average of 6.7 percent against the US dollar and 11.0 percent against the Euro; the Ruble nominal effective exchange rate against foreign currencies declined by 7.6 percent. By the end of 2018 the Ruble in real terms was traded against the currencies of U.S. trade partners at the level seen in September 2016 (see *Fig. 14*).

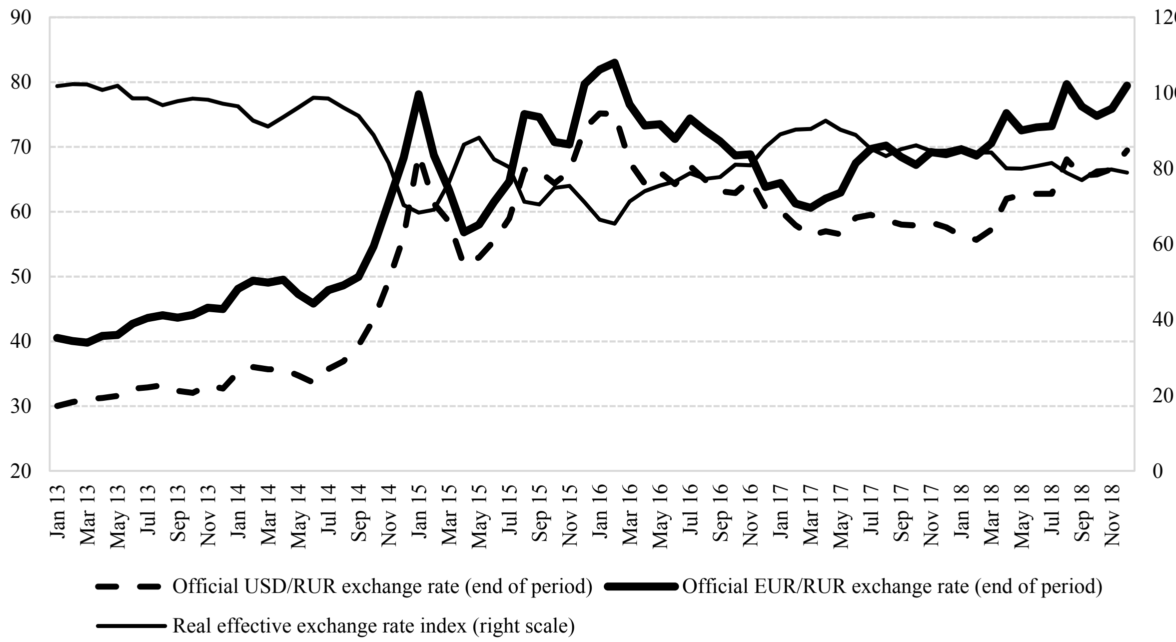


Fig. 14. Dynamics of Russian ruble exchange rate

Sources: Bank of Russia, own calculations.

The dynamics of the Russian ruble in 2018 was mostly led by Bank of Russia's foreign currency purchases in conformity with the fiscal rule in place. In 2018, the Bank of Russia spend RUB 3705.8 billion (3.6 percent of GDP) to buy foreign currency, the key factor of increasing Bank of Russia's foreign currency reserves until September 2018. The Bank of Russia adopted a decision in August 2018 to suspend its foreign currency purchases until late in September and then until late in 2018. It was not until mid-December that a decision to resume, from January 15, 2019, Bank of Russia's foreign currency purchases was announced. Until then foreign currency was purchased in planned volumes by the Federal Treasury directly from the Bank of Russia which had no access to the domestic foreign exchange market.

In 2018, the Russian ruble exchange rate as well as national currencies of other developing countries were influenced by the U.S. Fed's tighter monetary policy. The appeal of U.S. assets increased also due to heightened foreign-policy risks that can arise from U.S. protectionist measures against some of its trade partners.

A minor appreciation of the ruble real exchange rate, stabilization in value terms of export and import volumes, thus keeping a high current account balance unchanged – that is what seems to be expected in 2019 if *global crude prices remain as they are now* (around USD 60 per barrel) and *the ruble's nominal exchange rate is at 65–70 rubles per dollar*. However, risks of further tightening in sanctions, particularly sanctions against Russia's sovereign debt, may lead to capital outflows and a highly volatile ruble's exchange rate in 2019.

2.2. Fiscal policy[1]

2.2.1. Budgets characteristics in the budgetary system of Russia

Basic parameters of the budgetary system of Russia

In 2018, fiscal revenues of the enlarged government (hereinafter BEG) according to the preliminary data released by the Federal Treasury[2] exceeded the volumes seen in the previous year by 1.9 percentage points of GDP, or by RUB 5,870 billion in absolute terms (*Table 7*). At the same time, 75 percent of the income increment of BEG was secured by the federal budget including oil revenues to RUB 3,046 billion, or by 2.2 percentage points of GDP. Non-oil and gas receipts to the consolidated budget of the Russian Federation in 2018 compared to 2017 rose by RUB 2,824 billion in absolute terms but dropped in shares of GDP by 0.3 percentage points. Expenditures of Russia's budgetary system contracted in 2018 compared to January-December 2017 by 2.6 percentage points of GDP growing in absolute terms by RUB 1,485 billion.

In 2018, fiscal revenues of the budgetary system of Russia hit maximum for the five-year period which was mainly due to the favorable price environment on the natural resources. Budget expenditures of the enlarged government in shares of GDP in 2018 on the contrary reached minimum for the five-year period, which was possible due to budgetary rule in force, which significantly limited spending of the federal budget.

As a result, consolidated budget of the Russian Federation in 2018 was executed with a surplus (2.9 percent of GDP) for the first time during the period in review.

[1] This section was written by I. Arlashkin, RANEPA; N. Barbashova, RANEPA; S. Belev, Gaidar Institute, RANEPA; A. Deryugin, RANEPA; E. Leonov, Gaidar Institute, RANEPA; I. Sokolov, Gaidar Institute, RANEPA, VAVT; T. Tischenko, RANEPA.

[2] Data for 25.02.2019.

Tablea 7

Main parameters of the budget of the enlarged government in 2014–2018

	2014		2015		2016		2017		2018		Changes in 2018 relative to 2017, para GDP
	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% of GDP	RUB bn	% GDP	p.p. p. of GDP
Revenues, Including:	26 766	33.8	26 922	32.3	28 181	32.8	31 047	33.7	36917	35.6	1.9
- oil and gas	7434	9.4	5863	7.0	4844	5.6	5972	6.5	9018	8.7	2.2
- non-oil and gas	19 332	24.4	21 059	25.3	23 337	27.2	25 075	27.2	27 899	26.9	-0.3
Expenditures	27 612	34.9	29 741	35.7	31324	36.4	32 396	35.2	33881	32.7	-2.5
Deficit (-)/ Surplus (+)	-846	-1.1	-2 819	-3.4	-3 143	-3.6	-1 349	-1.5	3 036	2.9	4.4
Reference: GDP, RUB billion	79 200		83 387		86 010		92 089		103 627		

Sources: Federal Treasury, Rosstat.

Receipts from the main taxes to the budgetary system of Russia

According to 2018 figures, fiscal revenues of the consolidated budget moved up (*Table 8)*. Across the majority of certain components of the tax burden a positive receipts dynamics was observed.

Table 8

Receipts from the main taxes of the enlarged government of the Russian Federation in 2014–2018

	In percent of GDP					Change in 2018 against 2017 in p.p. of GDP	Growth in 2018 in prices of 2017 against 2017, %
	2014	2015	2016	2017	2018		
Revenues total	**33.7**	**31.9**	**32.1**	**32.6**	**35.0***	**2.4**	**15.8**
Corporate profit tax	3.0	3.1	3.2	3.6	4.0	0.4	19.5
PIT	3.4	3.4	3.5	3.5	3.5	0.0	7.8
Insurance contributions	6.3	6.4	6.7	6.4	6.3*	-0.1	6.1
VAT	5.0	5.1	5.4	5.6	5.8	0.2	12.3
Excises	1.4	1.3	1.6	1.7	1.5	-0.2	-4.7
NRET	3.7	3.9	3.4	4.5	5.9	1.4	42.3
Customs duties and levies	6.9	4.0	3.0	2.8	2.9	0.1	11.5

* insurance contributions and total revenues are given without double count of insurance contributions for economically inactive population, values of total revenues differ from the official data for given value.

Sources: Federal Treasury, Rosstat, own calculations.

Oil and gas revenues of the budget, which plummeted in 2016, in 2018 continued growing. The volume of customs duties and levies demonstrated an upward trend (by +0.1 percentage points of GDP against 2017, or +19.6 percent in real terms), and receipts from MET exhibited the highest growth by 1.4 percentage points of GDP (by 39.8 in real terms).

Insurance contributions and excises somewhat decreased, and receipts from VAT went up by 0.2 percentage points of GDP. Receipts form PIT since 2016 go along with GDP.

There were no serious changes in the parameters of the tax policy effective in 2018.

Oil and gas revenues. Base rate of MET-oil remained at RUB 919 per ton. In the wake of oil price growth there was an increase of oil and gas receipts (*Table 9*).

Table 9

Proceeds from export duties on energy products and MET in 2014–2018, percent of GDP

	2014	2015	2016	2017	2018
MET	3.7	3.9	3.4	4.5	5.9
Export duties of energy products:	5.8	3.3	2.3	2.1	2.9
Crude oil	3.3	1.7	1.2	1.1	1.5
Petroleum products	1.9	0.9	0.5	0.4	0.6
Natural gas	0.6	0.7	0.6	0.6	0.8

Sources: Rosstat, Bank of Russia, Federal Treasury, Federal Customs Service.

Analysis of tax and customs bases dynamics (*Fig. 15*) exhibits that in 2018 export and production of crude oil changed slightly or did not change against 2017: exports amounted to 257.5 million tons (+0.5 million tons against 2017), and extraction came to 555.8 million tons (up 9.1 million tons to 2017).

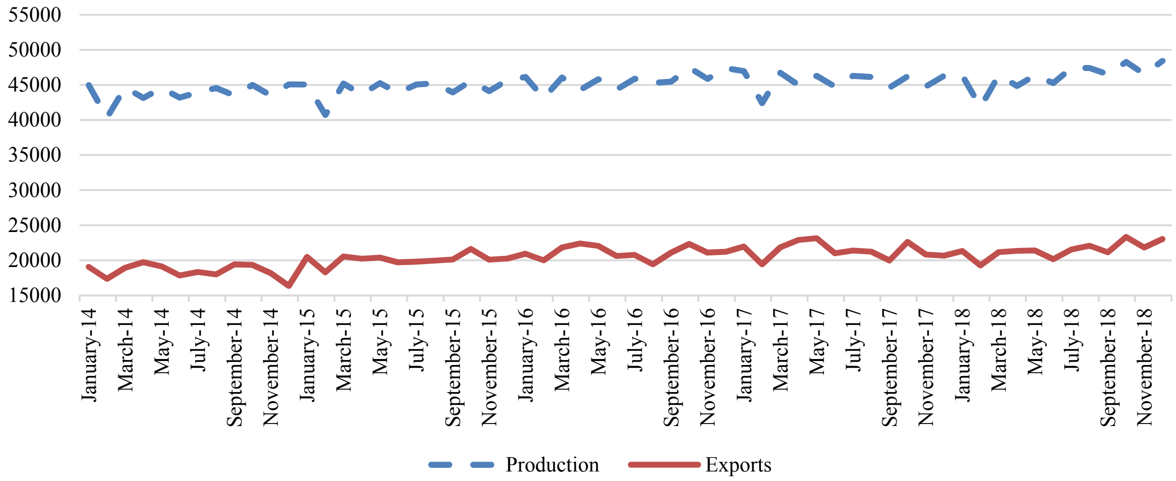


Fig. 15. Export and production of crude oil in 2014–2018, thousand tons

Source: Ministry of Energy of Russia.

Thus, Urals price growth was the main contribution to the growth of oil and gas revenues. USD exchange rate did not react to the oil price change owing to the fact that the Russian Finance Ministry abided to the budgetary rule (*Fig. 16*). As a result, actual ruble rate on MET averaged in 2018 over RUB 12,000 per ton of oil meanwhile in 2017 it averaged over RUB 7,800 per ton.

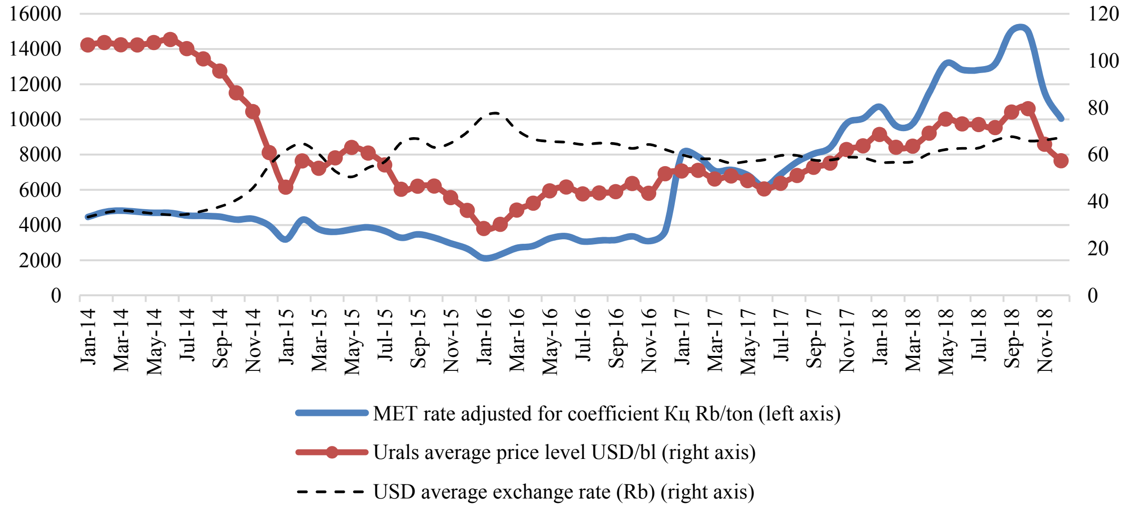


Fig. 16. Dynamics of actual tax rate on MET, Urals price and USD exchange rate in 2014–2018

Corporate income tax. In 2018, returns from the corporate income tax increased notably (ip0.4 percentage points of GDP). *Fig. 17* demonstrates significant income growth of the profit-making companies. Nevertheless, growing share of the loss-making enterprises is alarming.

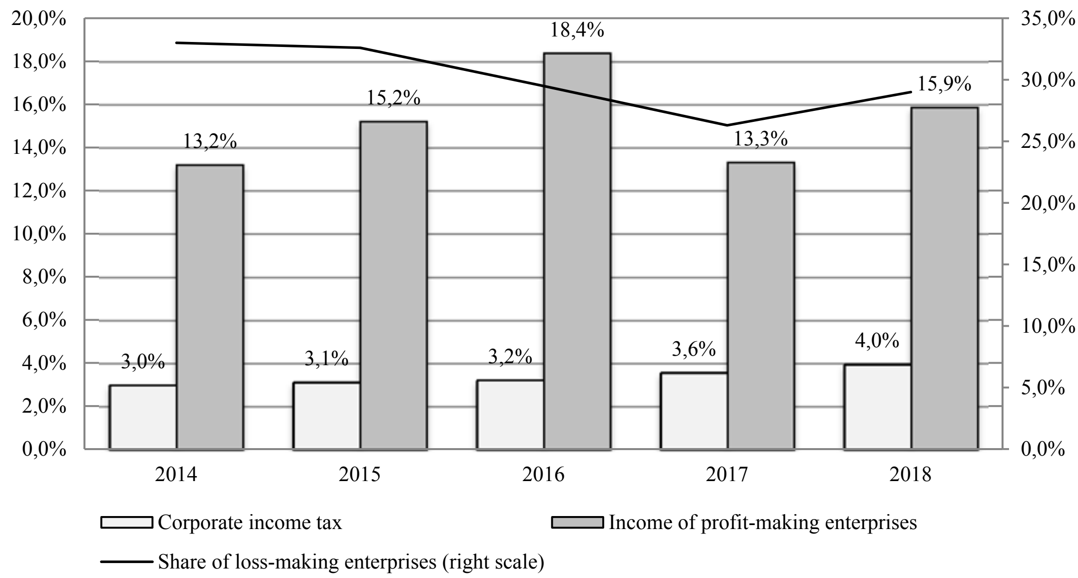


Fig. 17. Dynamics of proceeds from the corporate income tax to the budgetary system of the Russian Federation, income of profit-making enterprises (percent of GDP), share of loss-making enterprises in percent in 2014–2018

Sources: Federal Customs Service, Rosstat.

Insurance contributions and PIT. In 2018, there was no change in the rates and base of insurance contributions. Wage Fund of gross payroll relative GDP somewhat decreased. Meanwhile, returns from insurance contributions repeat the Fund's dynamic. Receipts from PIT consistently stay at the same level against GDP in recent years. This is due to the fact that the decrease of the tax base on 'wage' component was offset by the growth of other income subject to taxation along PIT.

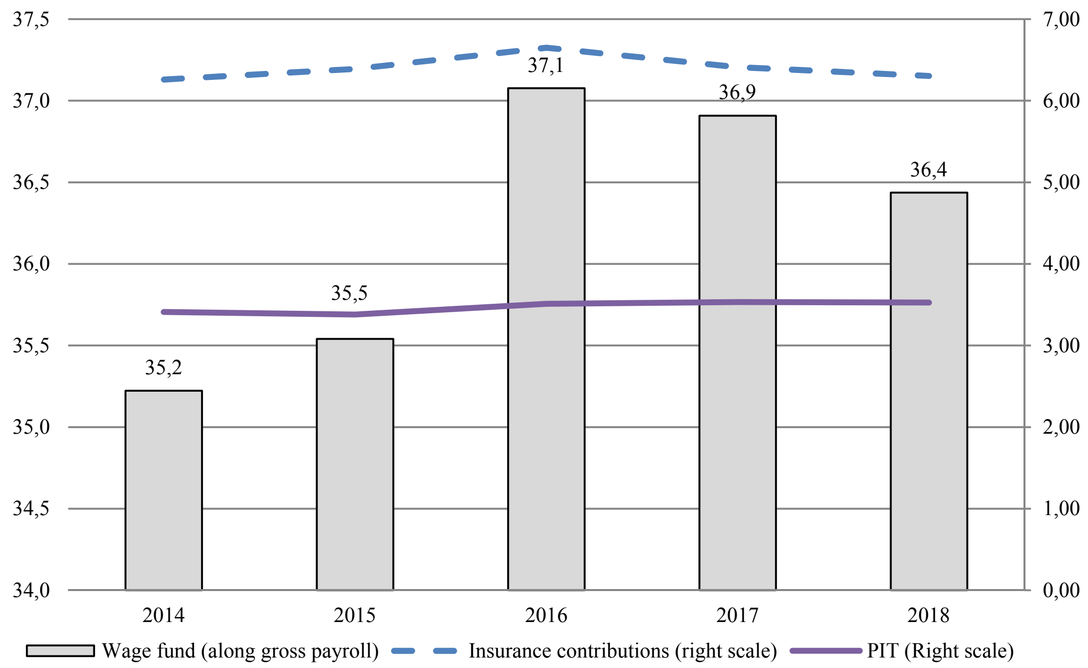


Fig. 18. Receipts from insurance contributions, PIT, and wage fund (along gross payroll) in 2013–2018, percent of GDP

Sources: Rosstat, Federal Treasury, own calculations.

VAT. Total receipts from VAT in 2018 rose by 0.2 percentage points hitting 5.8 percent of GDP. At the same time in 2018 contrary to 2017, significantly grew the share of VAT returns from imports in the increments of income amount. For example, in 2017, decisive contribution in the income growth (0.3 percentage points of GDP) was due to VAT on goods sold on the territory of the Russian Federation ("internal VAT") with insignificant VAT growth from imports (merely 0.02 percentage points of GDP), then in 2018, VAT growth from imports constituted nearly 0.2 percentage points, meanwhile income from "internal" VAT moved up merely by around 0.1 percentage points of GDP (*Table 10*).

It should be noted that in 2018, the imputed fiscal performance rose significantly strengthening upward trend which made itself felt after 2014 and reaching the highest level for the recent years. Receipts growth is due first of all to the ongoing usage of ACS

VAT-2 by customs bodies as well as to a certain decease of the shadow sector in the Russian economy.

Table 10

Dynamics of proceeds from VAT to the budgetary system of the Russian Federation, percent of GDP

	2014	2015	2016	2017	2018
Proceeds from VAT, total	5.0	5.2	5.3	5.6	5.8
VAT on goods sold on the RF territory	2.8	3.0	3.1	3.3	3.4
Vat on goods imported to the RF territory	2.3	2.2	2.2	2.3	2.4
Effective VAT rate, percent	7.5	7.8	8.0	8.6	9.7
Fiscal performance coefficient (C-efficiency), percent	41.5	43.5	44.6	47.5	53.7

Sources: Rosstat, Federal Treasury, own calculations.

Excises. In 2018, somewhat decreased returns from excises both on alcoholic beverages and tobacco products: collections from excises of these products in 2018 amounted to RUB 395 billion and RUB 583 billion, respectively.

Recent years have seen the contraction of consumption of practically all types of alcoholic beverages in volume terms. Thus, owing to the rates stability returns to the budget from excises on alcoholic beverages contracted by 0.4 percent in 2018 against 2017.

Tobacco products market has been steadily shrinking recently. When previously fiscal revenues were growing in the wake of excises rates gro9wth, then at year-end 2018 returns fell by nearly RUB 8 billion (down 1.3 percent compared to 2017). There are two reasons or this contraction:

1. Increase of the absolute volume of black market sales and correspondingly share of bootleg turnover on the falling market. For example, according to Euromonitor Int. estimates, the share of bootleg turnover moved up from 2.9 percent in 2014 to 6.5 percent in 2018.

2. Shifts in the market structure and switchover of part of consumers to electronic systems of nicotine provision (e-cigarette), which popularity and diversity grow all the more. This fact is reflected in the budget statistics: when in 2017 total collections from excises from e-cigarettes amounted to merely RUB 0.57 billion, in 2018 – already RUB 5.33 billion.

Table 11

Proceeds from excises on tobacco and alcoholic beverages, RUB billion.

	2014	2015	2016	2017	2018
Market volume of tobacco products (turnover of retail trade according to Rosstat)	553	633	701	775	n/a
Proceeds from excises on tobacco products (*less e-cigarettes)*	319	386	483	591	583
Alcoholic beverages market (retail trade turnover according to data released by Rosstat)	1871	1904	1933	1997	n/a
Proceeds from excises on alcohol	340	327	354	397	395

Sources: Rosstat, Federal Treasury, Federal Customs Service, own calculations.

Expenditures of the budgetary system of the Russian Federation

Expenditure of the budgetary system contracted in 2018 by 2.5 percentage points of GDP in comparison with 2017 level (*Table 12*).

Table 12

Budget expenditure of the enlarged government in 2014–2018, percent of GDP

	2014	2015	2016	2017	2018	Change in 2018 to 2017
Expenditure, total	**34.9**	**35.7**	**36.4**	**35.2**	**32.7**	**-2.5**
General state issues	2.1	2.2	2.2	2.1	2.1	0.0
National defense	3.1	3.8	4.4	3.1	2.7	-0.4
National security and law enforcement activities	2.8	2.5	2.3	2.2	2.0	-0.2
National economy	5.7	4.5	4.5	4.7	4.3	-0.4
Housing and utility sector	1.3	1.2	1.2	1.3	1.3	0.0
Environmental conservation	0.1	0.1	0.1	0.1	0.1	0.0
Education	3.8	3.6	3.6	3.5	3.5	0.0
Culture, cinematography	0.5	0.5	0.5	0.5	0.5	0.0
Healthcare	3.2	3.4	3.6	3.1	3.2	0.1
Social policy	11.1	12.6	12.7	13.1	11.6	-1.5
Physical fitness and sports	0.3	0.3	0.3	0.4	0.3	-0.1
Mass media	0.1	0.2	0.1	0.1	0.1	0.0
Servicing state and municipal debt	0.7	0.8	0.9	0.9	0.9	0.0

Sources: Federal Treasury, own calculations.

One should note downward trend in spending during 2018 against 2017 across the following budget lines: Social policy down 1.5 percentage points of GDP, National defense and National economy down0.4 percentage points of GDP, National security and law enforcement activities down 0.2 percentage points of GDP, physical fitness and sports down 0.1 percentage points of GDP. Only spending on Healthcare demonstrated growth 0.1 percentage point of GDP. Regarding other budget lines the volume of budget allocations in 2018 against 2017 in share of GDP remained unchanged.

The share of productive expenditures in the overall volume of the expenditure budget of the enlarged government in 2018 constituted 29.3 percent against 27.3 percent in 2017. Regarding certain lines of productive expenditures of the enlarged government budget in 2018 compared to 2017 under the general growth by 4.6 percent in nominal terms the following changes are observed:

- growth of budget allocations on fundamental research (up 27.4 percent), on applied research in the sphere of general state issues (up 2.3-fold), on applied research in the sphere of national defense (up 20.0 percent), on public road system (up 8.0 percent), on higher education (up 8.5 percent), on outpatient care (up 22.1 percent), and in-patient care (up 11.9 percent);
- reduction of budget allocations on transportation (down 3.2 percent).

National projects are the basic instruments for the implementation of the Presidential May Decree[1]. At the end of 2018, twelve national projects and a complex plan for modernization and extension of the long-distance infrastructure were developed.

[1] The Executive Order of the President of the Russian Federation of 07.05.2018 No. 204 “On National Goals and Strategical Objectives of the Russian Federation through 2024.”

Intersectoral feature has become a signature plank of such national projects. For instance, national project Demography consists of five federal projects[1]. Budget allocation on these projects are distributed across various sections of functional classification forming part of the following state programs: “Social safety net,” “Development of physical fitness and sports,” “Provision of accessible and comfortable housing and utilities citizens of the Russian Federation,” “Promotion of employment,” “Development of education,” “Development of healthcare,” and “Economic development and innovation-driven economy.” Participation of the RF subjects in the implementation of the national projects is achieved through the regional projects coordinated at the federal level. Planned volume of spending on the implementation of the national projects in 2019–2024 will amount RUB 25.7 trillion including along sources of financing: the federal budget – RUB 13.1 trillion, The RF subjects’ budgets – RUB 4.9 trillion, extrabudgetary sources – RUB 7.2 trillion, state extrabudgetary funds – RUB 0.1 trillion[2]. Achievement of objectives of the national projects will depend, first of all, on the efficiency of the interdepartmental coordination and attraction of funds from the extrabudgetary sources of financing.

Deficit of the budgetary system of the Russian Federation

At the year-end 2018, the budget of the enlarged government was executed with a surplus amounting to RUB 3,036 billion, or 2.9 percent of GDP against the budget deficit registered in 2017 to the tune of 1.5 percent of GDP, or RUB 1,349 billion (*Table 13*).

Table 13

Sources of financing the budget deficit of Russia in 2014–2018

	RUB billion					Percent of GDP				
	2014	2015	2016	2017	2018	2014	2015	2016	2017	2018
Sources of the deficit financing, total	**845**	**2 819**	**3 143**	**1 349**	**-3 036**	**1.1**	**3.4**	**3.7**	**1.5**	**-2.9**
Financing of deficit from internal sources	**4 478**	**1 713**	**-405**	**2 555**	**1 566**	***5.7***	***2.1***	***-0.5***	***2.8***	***1.5***
Government bonds	1 016	9	524	1220	507	1.3	0.0	0.6	1.3	0.5
Loans from credit organizations	217	102	-103	-126	-15	0.3	0.1	-0.1	-0.1	0.0
Other sources	3 245	1 602	-826	1 461	1 074	4.1	1.9	-1.0	1.6	1.0
Financing of the deficit from external sources	**-147**	**-296**	**15**	**-126**	**-135**	***-0.2***	***-0.4***	***0.0***	***-0.1***	***-0.1***
Government bonds	-47	-183	110	41	-50	-0.1	-0.2	0.1	0.0	0.0
Credits from foreign countries	-25	-51	-17	-20	-15	0.0	-0.1	0.0	0.0	0.0
Other sources	-75	-63	-78	-147	-70	-0.1	-0.1	-0.1	-0.2	-0.1
Change of remaining balance	**-3 486**	**1 402**	**3 533**	**-1 080**	**-4 467**	***-4.4***	***1.7***	***4.1***	***-1.2***	***-4.3***

Sources: Federal Treasury, own calculations.

[1] “Financial assistance to families at child birth,” “Promotion of women’s employment- creation of conditions for pre-school education for children to three years,” “Old generation,” “Older generation,” “Promotion of one’s health,” “Sports – way of lifeт».

[2] Website of the RF Government. URL: http://static.government.ru/media/files/p7nn2CS0pVhvQ98OOwAt2dzCIAietQih.pdf

In 2018 against the previous year, the amount of net borrowings[1] on the internal market significantly contracted from 1.3 percent of GDP to 0.5 percent of GDP, in particular, the volume of placed securities amounted to RUB 1,123.5 billion with the amount of redemption coming to RUB 616.0 billion (in 2017 –RUB 1,917.7 and 751.2 billion, respectively). Consolidated budgets of the RF subjects borrowed in bonds in 2018 amounting to RUB 86.9 trillion under the planned volumes coming to RUB 231.9 billion, the amount of redemption constituted RUB 86.9 trillion. Thus, the amount of regional debt on government bonds in 2018 remained unchanged and as of January 1, 2019 constituted RUB 551.4 billion (in 2017 – RUB 548.5 billion[2]), or 25 percent of the total state debt of the subjects of the Russian Federation (RUB 2,206.3 billion). Across other internal sources of the budget deficit financing it will be noted that returns from the sale of shares and other forms of participation in debt equity swap amounted to RUB 22.7 billion (in 2017 – RUB 22.8 billion), including regarding the consolidated budget of the subjects of the Russian Federation – RUB 10.0 billion (in 2017 – RUB 8.5 billion).

On the whole, the dynamics of the main parameters of the enlarged government budget in 2018 against the previous four-year period is in keeping with the policy of the budget consolidation, which ensures sustainability of the public finance in the medium-term, which, in its turn, is one of the significant factors for successful implementation of the national projects.

2.2.2. Specification of the federal budget

Basic parameters of the federal budget

In 2018, the revenue of the federal budget hit a fresh all-time high reaching 18.8 percent of GDP (RUB 19,457.9 billion), which is above their indicator for 2017 by 2.4 percentage points (*Table 14*). Growth of the gross income of the federal budget was triggered both by an increase of oil and gas components by 2.2 percentage points of GDP and by non-oil and gas proceeds by 0.2 percentage points of GDP. Furthermore, the volume of oil and gas income (8.7 percent of GDP) exceeded the original forecast values presented in the memorandum to the draft of the federal law on the federal budget for 2018-2020 by 3.1 percentage points of GDP.

The federal budget expenditures for 2018 amounted to 16.1 percent of GDP (RUB 16,664.7 billion) down 1.7 percentage points of GDP against the previous year (17.8 percent of GDP) and by 0.9 percentage points of GDP of the originally approved volume.

Budget surplus at the year-end 2018 hit 2.7 percentage points of GDP (RUB 2,793.2 billion) against 1.4 percentage points a year earlier. At the same time, non-oil and gas deficit contracted by 1.9 percentage points of GDP to -6.0 of GDP.

[1] The difference between the volume of placed securities and redeemed for the period under review.
[2] The difference of RUB 3 billion is due to the redemption of municipal securities of urban districts.

Table 14

Main parameters of the federal budget in 2014–2018, percent of GDP

	2014	2015	2016	2017	2018			Change in 2018 relative to 2017, p.p. of GDP
					Law on FB for 2018[1]	Law on FB for 2018 with amendments introduced in May[2]	Actually	
Revenues	18.3	16.4	15.7	16.4	15.7	17.4	18.8	2.4
Oil and gas	9.4	7.0	5.6	6.5	5.6	7.4	8.7	2.2
Non oil and gas	8.9	9.4	10.1	9.9	10.1	10.0	10.1	0.2
Expenditures	18.7	18.7	19.1	17.8	17.0	16.9	16.1	-1.7
Deficit (–) / surplus (+)	-0.4	-2.3	-3.4	-1.4	-1.3	0.5	2.7	4.1
Non-oil and gas deficit	-9.8	-9.3	-9.0	-7.9	-7.0	-6.9	-6.0	1.9
GDP, RUB billion	79 200	83 387	86 010	92 089	97 462	98 234	103 627[3]	
Urals USD per barrel	97.6	51.2	41.9	53.0	43.8	61.4	70.0	

Sources: Federal Treasury,[4] PRosstat, own calculations.

The share of oil and gas revenues on the overall amount of income in 2018 increased to 46.3 percent against 39.6 percent in 2017, however this dynamic can not attest to an increase of the dependence of the budget system sustainability on the oil and gas revenues because the growth of spending is limited by the budget rules and all additional oil and gas revenues are directed to the NWF. For instance, according to data released by the Finance Ministry of Russia additional oil and gas revenues obtained in 2018 due to the excess of the actual oil price[5] over the base one[6] are estimated in the volume of RUB 4,261.4 billion. Thus, the difference between the volume of fiscal revenues less additional oil and gas revenues (RUB 15,196.5 billion) and the nominal volume of the federal budget expenditures (provisional expected deficit) constitutes RUB 1,468.2 billion, or -1.4 percent of GDP[7].

Main sources of revenue

Parameters of the federal budget revenue part execution for 2018 on volumes and structure are presented in *Table 15*. The amount of collections from the oil and gas component went up by 2.2 percentage points of GDP due to the growth receipts from MET by 1.4 percentage points of GDP and to the export customs duties by 0.8 percentage points of GDP which was owing to the increase of Urals price growth (oil price at the year-end 2017 averaged USD 53.03 bbl against USD 70.01 bbl in 2018) and USD ruble exchange rate (RUB 58.3 per USD in 2017 against RUB 62.7 in 2018). Growth of oil and gas revenues was affected by a change in the computed interest rate on MET in terms of combustible natural gas with increasing Kgp coefficient for

1 Federal Law of 05.12.2017 No. 362-FZ.
2 Federal Law of 3.06.2018 No. 193-FZ.
3 Estimates of Rosstat as of 11.02.2019
4 According to data released by the Federal Treasury as of 07.02.2019.
5 USD 70.01 bbl.
6 USD 40.8 bbl.
7 Projected budget deficit exhibits that under the base oil price at USD 40.8 bbl the federal budget is not balanced by 1.4 percent of GDP.

organizations – owners of the United gas supply system in Q4 2018 (from 1.4022 to 2.055). The share of MET in the total volume of oil and gas revenues demonstrates a sustainable upward trend from 38.3 percent in 2014 to 66.6 percent in 2018 by means of reducing the share of proceeds from export duties (resulting from tax maneuver effective in the oil and gas sector).

Table 15

Proceeds of main taxes to the federal budget in 2014–2018

	Percent of GDP					Change in 2018 against 2017, p.p. of GDP
	2014	2015	2016	2017	2018	
Revenues, total	**18.3**	**16.4**	**15.7**	**16.4**	**18.8**	**2.4**
Oil and gas revenues	**9.4**	**7.0**	**5.6**	**6.5**	**8.7**	**2.2**
Of which:						
MET	3.6	3.7	3.3	4.4	5.8	1.4
Export duties	5.8	3.3	2.3	2.1	2.9	0.8
Non-oil and gas revenues	**8.9**	**9.4**	**10.1**	**9.9**	**10.1**	**0.2**
Of which:						
Corporate income tax	0.5	0.6	0.6	0.8	1.0	0.2
VAT on goods sold on the territory of the Russian Federation	2.8	2.9	3.1	3.3	3.4	0.1
VAT on goods imported into the territory of the Russian Federation	2.2	2.1	2.2	2.2	2.4	0.2
Excises on goods produced on the RF territory	0.7	0.6	0.7	1.0	0.8	-0.2
Excises on goods imported into the RF territory	0.1	0.1	0.1	0.1	0.1	0.0
Import duties	0.8	0.7	0.7	0.6	0.6	0.0
Other revenues	1.8	2.4	2.7	1.9	1.8	-0.1

Sources: Federal Treasury, own calculations.

The volume of non-oil and gas revenues of the federal budget in 2018 against the previous year rose across all fiscal revenues except internal excises, which contracted by 0.2 percentage points of GDP mainly due to a decrease of proceeds from excises on ethyl alcohol, gasoline, and tobacco products. Regarding other non-oil and gas revenues growth is noted in 2018 against the previous year: by 0.2 percentage points of GDP on the corporate income tax and import VAT, and by 0.1 percentage point of GDP on internal VAT. Returns from the corporate income tax transferred to the budget using corresponding rates increased by 0/1 percentage point of GDP, or by 29.8 percent in nominal terms. On the whole, non-oil and gas fiscal revenues are rather stable in recent years which confirms conclusions about the adaptation of the Russian economy to the impact of external negative factors.

The amount of non-tax revenues contracted in 2018 relative 2017 by 0.1 percentage points of GDP. However, regarding certain lines the following upward trend is noted in nominal terms:

- revenues in terms of income proceeding from the share in authorized (contributed) capital of partnerships and business companies, or dividends from shares owned by the Russian Federation, growth by 24.3 percent;
- revenues from placement of budget funds up 2.5-fold.

Federal budget expenditures

The federal budget expenditures in 2018 amounted to 16.1 percent of GDP, down 1.7 percentage points against 2017 with the growth by RUB 244.4 billion in absolute terms, or by 1.5 percent (*Table 16*).

Table 16

Federal budget expenditures in 2017–2018

	2017			2018			Change in 2018 relative to 2017	
	RUB bn	in % of GDP	Cash execution, %	RUB bn	in % of GDP	Cash execution, %	RUB bn	p.p. of GDP
Expenditures total, including:	**16 420.3**	**17.8**	**96.5**	**16 664.7**	**16.1**	**95.5**	**244.4**	**-1.7**
General state issues	1 162.4	1.3	93.1	1 235.8	1.2	88.9	73.4	-0.1
National defense	2 852.3	3.1	93.2	2 826.3	2.7	92.3	-26.0	-0.4
National security and law enforcement	1 918.0	2.1	97.8	1 971.0	1.9	96.2	53.0	-0.2
National economy	2 460.0	2.7	95.3	2 401.8	2.3	93.5	-58.2	-0.4
Housing and utility sector	119.5	0.1	95.6	148.4	0.1	88.1	28.9	0.0
Environmental conservation	92.3	0.1	99.2	116.0	0.1	98.8	23.7	0.0
Education	615.0	0.7	98.7	722.6	0.7	95.9	107.6	0.0
Culture and cinematography	89.7	0.1	91.1	94.5	0.1	84.3	4.8	0.0
Healthcare	439.8	0.5	97.3	537.3	0.5	96.3	97.5	0.0
Social policy	4 992.0	5.4	99.2	4 582.1	4.5	99.4	-409.9	-0.9
Physical fitness and sports	96.1	0.1	93.8	63.9	0.1	86.8	-32.2	0.0
Healthcare	83.2	0.1	99.9	88.4	0.1	99.9	5.2	0.0
Social policy	709.1	0.8	97.1	781.0	0.8	99.0	71.9	0.0
Interbudgetary transfers	790.7	0.8	95.3	1 095.4	1.1	99.7	304.7	0.3

Sources: Federal Treasury, own calculations.

Contraction in shares of GDP in 2018 relative 2017 is noted across the following lines:

- “Social policy” down 0.9 percentage points of GDP due to the decrease of budget allocations on “pension provision” from 3.9 percent of GDP to 3.0 percent of GDP;
- “National economy” down 0.4 percentage points of GDP including decrease of spending on the items “transportation” and “other issues in the sphere of national economy;”
- “National defense” down 0.4 percentage points of GDP through a decrease of spending on the item “Armed forces of the Russian Federation down 0.3 percentage points of GDP;
- “National security and law enforcement” and “General state issues” down 0.2 and 0.1 percentage points of GDP, respectively.

Growth of the federal budget allocations in 2018 compared to 2017 was solely on the line “Interbudgetary transfers” by 0.3 percentage points of GDP mainly owing to the increase of budget allocations on the item “other subsidies.”

On the whole, the federal budget structure regarding productive and non-productive expenditures has not changed significantly. The share of productive expenditures in the overall volume of expenditures moved up from 16.8 percent in 2017 to 18.4 percent registered in 2018 and has not changed in shares of GDP (3.0 percent of GDP).

Regarding cash execution of the federal budget in 2017-2018 against the approved annual parameters one can note that for 2017 the share of execution hit 96.5 percent of the annual budget of the annual budget breakdown, meanwhile, for twelve months of 2018 cash execution constituted 95.5 percent.[1] As during the previous year, the maximum volume of implemented budget allocations over 99.0 percent is registered in 2018 across budget lines "Social policy," and Mass media. Underdogs regarding cash execution of the federal budget in 2018 (below 90 percent) were budget lines "General state issues," "Housing and utility sector," "Culture and cinematography," and "Physical fitness and sports."

Analysis of the implementation of budget allocations across executive performers of state programs (*Table 17*) at the year-end 2017-2018 revealed somewhat improvement with the implementation of state program "Implementation of state national policy" (75.7 percent against 66.3 percent) and decrease of cash execution across all other state programs presented in the table.

Table 17

State programs with the lowest percent of expenditure execution in 2017–2018

No.	Program	Executive body[2]	Execution, %	
			2017	2018
1	Implementation of state national policy	Federal agency for national affairs	66.3	75.7
2	Development of pharmaceutical and medical industry for 2013–2020	Ministry for industry and trade	81.6	62.9
3	Space activity of Russia for 2013-2020	Federal space agency	82.8	74.4
4	Reproduction and use of natural resources	Ministry of natural resources and environmental protection	91.2	88.5
5	Development of culture and tourism for 2013–2020	Ministry of culture	91.3	82.8

Sources: Federal Treasury, own calculations.

Deficit and debt at the federal level

At year-end 2018, cash flow from the sources of financing the budget deficit demonstrated the following dynamics (*Table 18*):

- the amount of borrowing on the internal market has contracted to RUB 1,036.6 billion against RUB 1,756.4 billion registered in 2017. However, the volume of repayment decreased from RUB 632.9 billion in 2017 to RUB 529.0 billion;
- volume of receipted obtained from the sale of shares and other forms of equity participation in the state ownership – RUB 12.8 billion (in 2017 – RUB 14.3 billion);
- purchase/sale of precious metals and precious stones register negative balance (receipts in 2018 – RUB 6.2 billion, purchases – RUB 8.5 billion in 2017 – 7.6 and 6.0 billion, respectively);
- receipts from the repayment of the budget loans extended for the partial coverage of the deficit of the RF subjects' budgets constituted RUB 69.9 billion. According to the

[1] According to real-time data. According to final data, cash execution can increase.
[2] Executive performer is indicated in the passport of SP not taking into consideration changes in the structure of the Federal bodies of executive power.

operative records budget loans in the line were not extended (in 2017, there was a negative balance regarding extension/repayment of budget loans amounting to RUB -20.3 billion);

- the amount of placement of state bonds in the external market also decreased from RUB 405.5 billion in 2017 to RUB 120.2 billion 9in 2018 with the repayment volume at RUB 194.6 billion in 2018 against RUB 364.7 billion in 2017.

Table 18

Sources of financing of the federal budget deficit in 2014–2018

	RUB billion					Percent of GDP				
	2014	**2015**	**2016**	**2017**	**2018**	**2014**	**2015**	**2016**	**2017**	**2018**
Sources of financing deficit, total	**334**	**1 961**	**2 956**	**1 331**	**-2 793**	**0.4**	**2.4**	**3.4**	**1.4**	**-2.7**
Financing of deficit from internal sources	***4 076***	***1 242***	***-684***	***2 091***	***1 386***	***5.1***	***1.5***	***-0.8***	***2.3***	***1.3***
State securities	1 025	15	492	1 123	507	1.3	0.0	0.6	1.2	0.5
Other sources	3 051	1 227	-1 176	968	879	3.9	1.5	-1.4	1.1	0.8
Financing of deficit from external sources	***-147***	***-296***	***43***	***-126***	***-161***	***-0.2***	***-0.4***	***0.0***	***-0.1***	***-0.2***
State securities	-47	-183	110	41	-74	-0.1	-0.2	0.1	0.0	-0.1
Credits from foreign countries	-25	-51	-17	-20	-17	0.0	-0.1	0.0	0.0	0.0
Other sources	-74	-63	-50	-147	-70	-0.1	-0.1	-0.1	-0.2	-0.1
Change in remaining balance	***-3 595***	***1 015***	***3 597***	***-634***	***-4 018***	***-4.5***	***1.3***	***4.2***	***-0.8***	***-3.8***

Sources: Federal Treasury, own calculations.

As of December 31, 2018, the state debt amounted to RUB 12,581 billion (12.1 percent of GDP against 12.6 percent in 2017), including internal debt amounting to RUB 9,170 billion (increase by RUB 500 billion), external – USD 49.1 billion (reduction by USD 0.7 billion).

National Wealth Fund (NWF) at the year-end of the reporting period amounted to RUB 4,036.0 billion (up RUB 283.1 billion), or 3.9 percent of GDP. The exchange rate difference obtained from the NWF funds revaluation constituted RUB 489.7 billion. During 2018, the following transactions with the NWF funds took place:

- decrease by RUB 5.1 billion for co-financing of pension savings of insured individuals who paid additional insurance contributions for the savings pension;

- decrease by RUB 1,108.2 billion to secure balancing (deficit payments) the Pension fund budget of the Russian Federation;

- returns of RUB 906.7 billion from additional oil and gas revenues of the federal budget in 2017[1].

Main funds of the NWF in ruble terms amounting to RUB 2,355.5 billion are deposited on the accounts of the Bank of Russia in foreign currency. Total funds of the NWF invested in securities of Russian issuers for the implementation of self-funding infrastructure projects constitute RUB 446.4 billion, and in senior shares of credit organizations – RUB 279.0 billion.

Regarding dynamics of the federal budget deficit, state debt, and sovereign funds (RF and NWF through 2018) in shares of GDP in 2014-2018 (*Fig. 19*) one should note that

[1] In keeping with the order of the Finance Ministry of Russia of June 9, 2018 No. 955 “On the use of additional oil and gas revenues in the federal budget obtained in 2017”.

the most difficult situation with the budget sustainability was registered in 2016 when there occurred significant nearly twofold contraction of the sovereign funds and the budget deficit rose to 3.4 percent of GDP. At the same time, the positive balance of the federal budget execution in 2018 did not significantly affect on the state debt and sovereign reserves registered in the NWF, and in shares of GDP. Dynamics of the primary deficit in 2014–2018 correlates with dynamics of the budget deficit, with the maximum negative value -2.7 percent of GDP in 2016 and maximum positive value 3.5 percent of GDP registered in 2018.

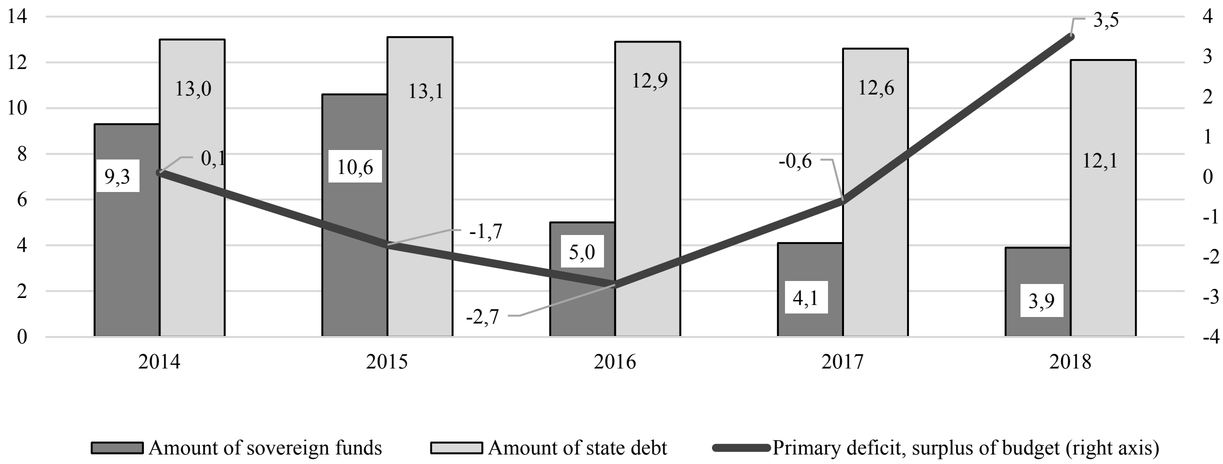


Fig. 19. Dynamics of the federal budget deficit, state debt, and sovereign funds (RF, NWF through 2018) in 2014-2018, percent of GDP

Sources: Federal Treasury, own calculations.

Summarizing dynamics and structure of the main parameters of the federal budget in 2018 both against five-year period and against the previous year one should note the development of a positive trend along fiscal revenues as well as maintaining expenditures, state debt, and amount of the NWF at the acceptable for the ensuring financial sustainability level.

2.2.3. Interbudgetary relations and subnational finances

Analysis of main parameters of the consolidated budgets of the RF subjects

Primary trends in the relations between various levels of power are reflected in the structure of revenues and expenditures of the consolidated budgets of the subjects of the Russian Federation. *Fig. 20* provides data reflecting the share of tax and non-tax revenues and final expenditures of the consolidated budgets of the RF subjects in the overall amount of tax and non-tax revenues and final expenditures of the RF consolidated budget and state extrabudgetary funds.

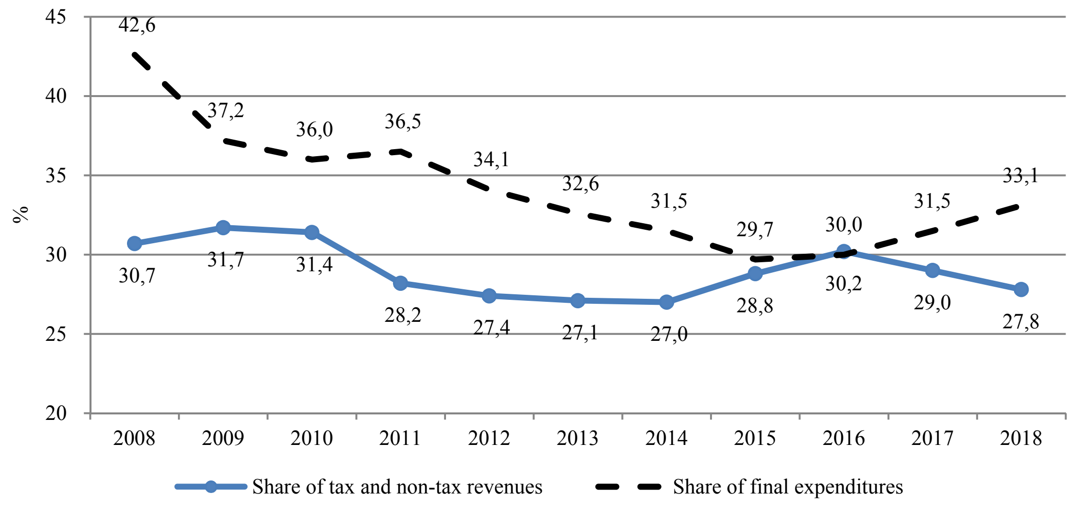


Fig. 20. Share of tax and non-tax revenues and expenditures of budgets of the budgetary system of the Russian Federation in 2008–2018

Sources: Federal Treasury, own calculations.

Fig. 20 demonstrates that in 2014–2016 there was a certain decentralization of tax and non-tax revenues. However, later on trends changed: 2017 saw increased centralization of fiscal revenues at the federal level with simultaneous growth of regional spending obligations. Share of tax and non-tax revenues of the consolidated regional budgets in tax and non-tax revenues decreased from 30 percent in 2016 to 29 percent in 2017, and correspondingly the share of final expenditures in the budgetary system expenses for the same years increased from 30.0 percent to 31.5 percent. In 2018, this trend remained: the share of regional and local budgets in tax and non-tax revenues fell to 27.8 percent, and their share in final expenditure moved up to 33.1 percent. Thus, imbalance between the level of decentralization of revenues and expenditures of the regional budgets in 2018 continued growing.

Let's analyze in more detail the revenues part of subnational budgets. Dynamics of the main components of revenues of the consolidated budgets of The RF subjects is given in *Table 19*. The right side of the table demonstrates revenues in real terms (adjusted for inflation)[1].

As is seen from *Table 19*, the dynamics of the real regional revenues exhibit upward trend since 2016. Revenues of the consolidated budgets of the RF subjects demonstrate growth in 2018 vis-à-vis 2017 by 10.5 percent in real terms. This is the most significant increment of regional revenues for the period since 2014. At the same time, the real tax revenues rose approximately to the same extent as the total amount of fiscal revenues (by 10.2 percent), and the real non-tax revenues contracted somewhat (by 2.5 percent). One should note a significant growth of the real amount of interbudgetary transfers by 17.4 percent, which is the highest increment registered for the period under review. The

[1] According to data released by Rosstat consumer price index in 2018 constituted 4.3 percent.

corporate income tax (increment of returns in real term constituted 17.8 percent) exhibits the best dynamics in the framework of tax revenues. Tax returns into the consolidated budgets of The RF subjects have also risen in real terms across such taxes as PIT (up 7.8 percent), property taxes (up 7.2 percent), taxes of aggregate income (up 11.6 percent). In the meantime, there is a small reduction of proceeds from excises (down 0.8 percent in real terms in comparison with 2017). However, in the wake of a slight share of excises in the structure of consolidated regional budgets this reduction is not reflected in the total income dynamics. To note, in 2017 the real returns from excises were also contracting compared to 2016.

Table 19

Revenues of the consolidated budgets of The RF subjects in 2014–2018

	In nominal terms, RUB billion.					Real increase, %			
	2014	2015	2016	2017	2018	2015/ 2014	2016/ 2015	2017/ 2016	2018/ 2017
Revenues, total	**8 906**	**9 308**	**9 924**	**10 758**	**12 392**	**-7.4**	**1.2**	**5.8**	**10.5**
Tax and non-tax revenues	**7 177**	**7 625**	**8 289**	**8 986**	**10 222**	**-5.9**	**3.2**	**5.8**	**9.1**
Including tax revenues:	*6 493*	*6 925*	*7 574*	*8205*	9 429	*-5.5*	*3.8*	*5.7*	*10.2*
Corporate income tax	1 964	2 108	2 279	2528	3 105	-5.0	2.6	8.2	17.8
PIT	2 693	2 808	3 019	3252	3 654	-7.7	2.0	5.1	7.8
Excises	480	487	662	612	632	-10.2	29.1	-9.8	-0.8
Taxes on aggregate income	315	348	388	447	520	-2.3	6.0	12.2	11.6
Property taxes	957	1 069	1 117	1 250	1 397	-1.2	-0.8	9.2	7.2
Non-tax revenues	*685*	*700*	*715*	*781*	*794*	*-9.4*	*-3.0*	*6.5*	*-2.5*
Transfers from other budgets	**1 671**	**1 617**	**1 578**	**1 703**	**2 085**	**-14.3**	**-7.4**	**5.3**	**17.4**
Other revenues	**58**	**66**	**56**	**69**	**85**	**2.0**	**-19.2**	**18.7**	**18.2**

Sources: Federal Treasury, own calculations.

Let us analyze in more detail the situation with returns of tax and non-tax revenues across regions (*Table 20*).

Table 20

Classification of regions along growth rates of main types of tax and non-tax revenues of the consolidated budgets of the RF subjects in 2017–2018

	Change in main types of tax and non-tax revenues of consolidated budgets of the RF subjects to the previous year											
	Growth by more than 25%		Growth from 10 to 25%		Growth less than 10%		Decrease less than 10%		Decrease from 10 to 25%		Decrease by more than 25%	
	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018	2017	2018
In real terms												
Tax and non-tax revenues, total	5	**4**	16	**46**	48	**33**	13	**2**	3	**0**	0	**0**
Corporate income tax	18	**26**	29	**29**	18	**13**	9	**9**	5	**5**	6	**3**
PIT	1	**3**	9	**50**	69	**31**	5	**0**	1	**0**	0	**0**
In real terms												
Tax and non-tax revenues, total	3	**2**	12	**25**	48	**54**	18	**3**	4	**1**	0	**0**
Corporate income tax	18	**16**	22	**26**	24	**22**	8	**10**	7	**8**	6	**3**
PIT	0	**2**	1	**11**	72	**68**	11	**4**	1	**0**	0	**0**

Sources: Federal Treasury, own calculations.

Comparison of change in the amount of main types of regional and local budgets revenue sources leads to the following conclusion. Since 2016, the revenue vector on average across Russia changed its course from recession to growth. In 2017–2018, dynamics of revenues of the consolidated budgets of the RF subjects continued its upward trend. The number of "fast growing" regions (revenue growth rate in real terms over 25 percent) decreased from 3 to 2. In 2017 the highest tax and non-tax revenues growth rates were demonstrated by Republic of Crimea, Republic of Kalmykia, and Nenets autonomous district. In 2018 the leaders were Khanty-Mansi autonomous district, and Tyumen region.

To note, on the whole growth rates of tax and non-tax revenues of the regional and local budgets in 2018 were above the corresponding rates demonstrated in 2017. In 2017 the number of regions with revenues growth in real terms from 10 to 25 percent came to 12. In 2018, this number increased to 25. The most numerous remains the group of regions with the real revenues growth to 10 percent (48 subjects in 2017, and 54 subjects in 2018).

Compared to 2017, fell the number of regions where the real volume of tax and non-tax revenues of the consolidated budgets was decreasing against to the previous year. In 2017, the number of such regions constituted 16 (reduction of revenues in nominal terms) and 22 (reduction in real terms). In 2018, decrease of nominal revenues is observed in two subjects (Republic of Crimea[1] and Republic of Mariy El), and in real terms in four subjects (in addition to mentioned above Chukotka autonomous district and Ryazan region).

The corporate income tax hit the regional budgets in 2018 ahead of schedule. The number of subjects which registered the increase of returns on this tax in real terms grew over the year by more than 25 percent constituted 16 in 2018 (in 2017 there were 18 such subjects). Front runners regarding revenues growth are Khanty-Mansi autonomous district (158 percent), Republic of Karelia (94 percent), and Republic of Sakha (68 percent). All these three subjects in the previous year faced contraction of the real returns on the corporate income tax (Khanty-Mansi autonomous district – by 33 percent, Republic of Sakha – by 34 percent, and Republic Karelia – by 8 percent), i.e. for them to a considerable extent 2018 growth is an offset one. Following the results of the last two years, persistently high increments of the corporate income tax returns were demonstrated by Vologda region: 32 percent in 2017 and 61 percent in 2018. Among the regions with the highest growth rates on this tax also are Tyumen region (64 percent in real terms), and Republic of Bashkortostan (56 percent in real terms). Decrease of the real returns from the corporate income tax was observed in 21 regions – just as much as in 2017. The situation with the highest decrease of tax returns can be called a "mirror-like" one regarding the situation with the maximum growth of tax returns. Regions that were the front-runners in tax returns growth in 2017 registered the highest tax returns decrease in 2018. For example, the highest decrease of the real tax returns on the corporate income tax in 2018 was observed in Republic of Crimea (67 percent), which

[1] Republic of Crimea in 2017 demonstrated the highest growth rates of proper revenues.

was the front-runner on tax returns growth on this type of tax in 2017 (214 percent). The same situation is observed in Republic Mariy El (in 2018 down 42 percent with growth at 59 percent in 2017), and Republic Tyva (in 2017 up 66.1 percent, and in 2018 down 36 percent). To note that Sakhalin region registered returns on the corporate income tax both in 2017 (43 percent in real terms) and in 2018 (19 percent).

Average growth rates of returns from PIT in 2018 into the consolidated regional budgets outstrip indicators of 2017: when in 2017 solely one region boasted of the growth of returns on this tax by more than 10 percent in real terms (Lipetsk region – 23 percent) then in 2018 there were 14 such regions. Front runners were Republic of Khakassia (73 percent in real terms), Republic of Dagestan (25 percent), and Tyumen region (22 percent). Decrease of proceeds from PIT in real terms in 2018 took place solely in 4 regions (Lipetsk region – contraction by 3 percent< Krasnodar territory – by 2 percent, Republic of Mordovia and Vladimir region – less than 1 percent). In 2017 there 12 such subjects.

Let us analyze changes in the expenditure part of the consolidated budgets of the RF subjects in 2018 (*Table 21*).

Table 21

Expenditures of the consolidated budgets of the RF subjects

	% to total		% of GDP		Change	
	2017	2018	2017	2018	In nominal terms, %	p.p. of GDP
General state issues	6.1	6.3	0.71	0.72	14.05	0.01
National security and law enforcement	1.1	1.2	0.13	0.13	19.14	0.01
National economy, including:	21.2	20.8	2.48	2.38	7.87	-0.10
Agriculture and fisheries	2.5	2.3	0.29	0.26	1.01	-0.03
Transport	5.2	4.7	0.61	0.54	-0.07	-0.07
Public road system (road funds)	8.8	8.9	1.03	1.02	11.12	-0.01
Other issues in the sphere of national economy	4.7	4.9	0.55	0.56	14.19	0.01
Housing and utility sector	10.4	10.2	1.22	1.17	7.60	-0.05
Environmental conservation	0.3	0.3	0.03	0.04	48.65	0.01
Education, including:	24.9	25.4	2.92	2.91	12.10	-0.01
Housing and utility sector	6.7	7.1	0.78	0.81	16.53	0.03
Environmental conservation	12.2	12.2	1.43	1.40	10.34	-0.03
Education, including:	1.9	1.9	0.22	0.21	9.35	-0.01
Housing and utility sector	4.2	4.2	0.49	0.49	11.41	0.00
Culture, cinematography	3.8	3.7	0.45	0.43	7.56	-0.02
Healthcare	7.8	8.0	0.92	0.92	12.22	0.00
Social policy	20.4	20.3	2.40	2.33	9.40	-0.07
Physical fitness and sports	2.3	2.4	0.28	0.27	11.47	0.00
Mass media	0.4	0.4	0.05	0.05	9.12	0.00
Servicing state and municipal debt	1.2	0.9	0.15	0.11	-16.83	-0.04
Expenditure, total	**100.0**	**100.0**	**11.74**	**11.47**	**9.92**	**-0.27**

Sources: Federal Treasury, own calculations.

From *Table 21* it follows that the functional structure of the regional expenditure in 2018 changed slightly compared to the previous year. All structural changes were in the range of 1 percentage point. Among major structural changes, one should note decrease of spending on national economy by 0.4 percentage points (mainly due to transportation), reduction of spending on servicing state and municipal debt by

0.3 percentage points, as well as growth of expenses on education by 0.5 percentage points. Major contribution in the increment of educational expenses was due to preschool education.

Virtually all functional components of the regional expenses moved up in nominal terms in 2018 except spending on servicing state and municipal debt (contraction by 16.8 percent) and transportation (reduction by 0.1 percent). In real terms, expenses also fell on agriculture, housing and utility sector, culture and social policy. To note, spending on agriculture was falling relative to the previous year also in 2017 both in nominal and real terms.

One should note significant growth of certain types of expenditure in social sphere: education (first of all preschool) and healthcare. Expenses on environmental conservation increased two-fold, however the share of this type of spending remains insignificant (0.3 percent in the overall volume of expenditure and 0.04 percentage points of GDP). The overall share of expenditure of the consolidated budgets of the RF subjects in GDP in 2018 decreased by 0.27 percentage points in comparison with 2017.

Let us analyze dynamics of the main parameters of the consolidated budgets of the RF subjects in shares of GDP (*Table 22*).

Table 22

Dynamics of revenues and expenditures of the consolidated budget of the RF subjects, percent of GDP

	2014	2015	2016	2017	2018
Revenues	**11.24**	**11.16**	**11.54**	**11.68**	**11.96**
including:					
Corporate income tax	2.48	2.53	2.65	2.74	3.00
PIT	3.40	3.37	3.51	3.53	3.53
Transfers from Federal budget	2.11	1.94	1.83	1.85	2.01
Expenditures	**11.81**	**11.37**	**11.55**	**11.74**	**11.47**
Deficit (-) / Surplus (+)	**-0.57**	**-0.21**	**-0.01**	**-0.06**	**0.49**

Sources: Federal Treasury, own calculations.

Table 22 demonstrates that in the course of three years both revenues of the subnational budgets as a whole and proceeds from PIT and the corporate income tax were growing in shares of GDP. During 2014-2016, transfers from the federal budget were contracting. In 2017 they somewhat increased and in 2018 continued growing. Expenditures of the subnational budgets increased in 2016–2017, but somewhat decreased in 2018.

Financial assistance from the federal budget

Total volume of interbudgetary transfers from the federal budget distributed between regions significantly increased in 2018[1] compared to 2017 both in nominal terms (+21.0 percent) and in shares of GDP (+1.4 percentage points of GDP (*Table 23*). The increment was, first of all, due to growing subsidies on securing balancing (+2.2 percentage points of GDP) offsetting partial reduction of subsidies for the fiscal

[1] Data for 2018 is preliminary because it is put together on the basis of monthly reports of budget execution as of January 1, 2019, and not on the annual reports.

equalization (-0.5 percentage points of GDP). The volume of other interbudgetary transfers has grown notably (+0.8 percentage points of GDP). Within other types of transfers subsidies have undergone the highest reduction (-0.9 percentage points of GDP), where subsidies on the development of national economy contracted by more than 21 percent in comparison with 2017. For instance, in 2018 the share of subsidies (undesignated financial assistance) moved up by 5.7 percentage points in comparison with 2017 and exceeded 50 percent.

Table 23

Transfers to the budgets of the subjects of the Russian Federation from the federal budget

	2016		2017		2018		Increment in 2018 to 2017	
	RUB bn	% to total	RUB bn	% to total	RUB bn	% to total	nominal, %	p.p. of GDP
Transfers to regions, total	**1 567.8**	**100.0**	**1 690.1**	**100.0**	**2 044.8**	**100.0**	**21.0**	**1.4**
Subsidies	**656.2**	**41.9**	**759.0**	**44.9**	**1 035.5**	**50.6**	**36.4**	**1.8**
Including:								
Grants for budget equalization	513.7	32.8	614.5	36.4	644.5	31.5	4.9	-0.5
Grants for ensuring budgets' balance	131.7	8.4	133.8	7.9	380.4	18.6	184.2	2.2
Subsidies	**356.5**	**22.7**	**419.8**	**24.8**	**381.8**	**18.7**	**-9.0**	**-0.9**
Including:								
Subsidies for development of national economy	231.9	14.8	242.4	14.3	190.0	9.3	-21.6	-0.8
Subventions	**334.3**	**21.3**	**326.1**	**19.3**	**331.7**	**16.2**	**1.7**	**-0.3**
Other interbudgetary transfers	**220.8**	**14.1**	**185.1**	**11.0**	**295.8**	**14.5**	**59.8**	**0.8**

Sources: Federal Treasury, Rosstat, own calculations.

The volume of subventions contracted (0.3 percentage points of GDP), which demonstrated a small decrease of dependence of the subnational budgets regarding execution of delegated powers. This trend is characteristic of several recent years. At the same time, the number of subventions[1] compared to 2017 increased by two and constitutes 32. Nine subventions are for Republic of Crimea and the city of Sebastopol, besides two of them duplicate those which are given to other subjects of the Russian Federation.

The amount of subsidies granted in 2018 constituted 74. The same amount of subsidies were granted in 2017. The state program "Development of the Federative Relations and Creation of Conditions for Effective and Responsible Management of Regional and Municipal Finances" (hereinafter – SP "Development of the Federative Relations…") envisages a reduction of the number of subsidies in 2018 down to 57. Thus, the process of consolidation and optimization of the number of subsidies was halted.

[1] The number of transfers is determined by the number of unique items of expenditure (13-16 code positions in the classification of budget expenditure), envisaged in the report on the federal budget execution.

The volume of other interbudgetary transfers has significantly increased both in nominal terms (+59.8 percent) and in shares of GDP (+0.8 percentage points of GDP). Their number moved up: when in 2017 the federal budget granted regions 77 other types of interbudgetary transfers then in 2018 – already 93. Because other interbudgetary transfers are distributed on a less transparent and formalized basis than the subsidies (which volume has decreased), one should consider that the structure of provision of targeted financial assistance to the regions has deteriorated.

In the meantime, the share of non-targeted assistance has increased, which allowed to over fulfill the targeted value of the corresponding indicator of SP "Development of Federative Relations…": the share of subsidies in the interbudgetary transfers granted to regions constituted 50.6 percent under the planned one of 48 percent. However, if we consider that grants provided for partial compensation of additional expenses for raising wages of the budget sphere employees in essence are rather subsidies than grants, then the share of grants (less indicated ones) will constitute solely 45.7 percent.

It should be noted that the growth of the share of grants in mainly ensured by the growth of grants on support of measures for budget balancing, which contrary to equalization transfers are distributed on a less transparent and formalized basis.

When analyzing granting by the federal canter of transfers to the regions it is important to analyze the effect of the federal assistance on the income differences of the subjects of the Russian Federation, assessing the leveling features of the financial assistance from the federal budget (*Table 24*).

Table 24

Coefficient of variation of income of the consolidated regional budgets (per capita inclusive of index of budget expenditure)

Year	Tax revenues	Tax revenues and equalization transfers	Tax revenues, subsidies, subsidies
2014	0.590	0.512	0.499
2015	0.661	0.603	0.560
2016	0.556	0.421	0.373
2017	0.558	0.413	0.377
2018	0.593	0.433	0.381

Sources: Federal Treasury, Finance Ministry of Russia, own calculations.

As seen from *Table 24*, in 2018 compared to the previous year the differentiation of tax revenues of the subnational budgets increased quite a bit. Consequently, differentiation of the subnational budgets increased following the equalization and after provision of grants and subsidies, however equalization effect from provision of these types of transfers has remained. For instance, after the equalization the differentiation decreased by 27 percent (in 2017 – by 26 percent), and after the provision of grants and subsidies – by 36 percent (in 2017 – by 32 percent).

Regional deficit and debt

Income growth and curbing of spending growth of the regional consolidated budgets in 2018 positively affected their balancing: for the first time over last eleven years surplus of the consolidated budgets of the RF subjects was registered, the amount of which hit all-time maximum – RUB 0.5 trillion.

Regional data reveals increased balancing of the consolidated budgets of the majority of the RF subjects. The number of subjects with the budget deficit in 2018 decreased by more than 3-fold compared to 2017 and came to 15 (*Table 25*).

Table 25

Execution (deficit/surplus) of the consolidated budgets of the RF subjects in 2014–2018

Year	Number of RF subjects which executed budget with	
	deficit	surplus
2014	74	11
2015	76	9
2016	56	29
2017	47	38
2018	15	70

Sources: Federal Treasury, own calculations.

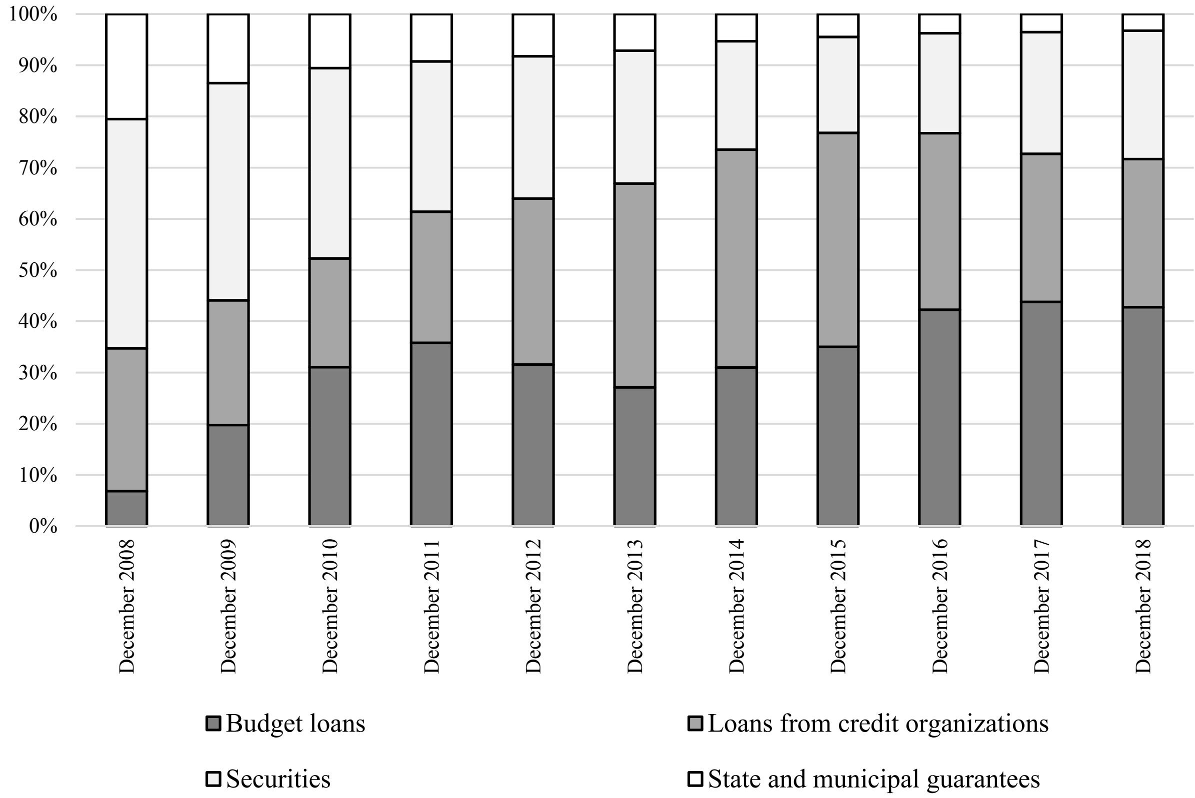
Improved parameters of fiscal balance of the majority of the regions positively affected the dynamic of their state debt, which at year-end 2018 decreased from RUB 2.32 to 2.21 trillion.

As against the volume of tax and non-tax revenues of the budgets of the RF subjects for 2018 it contracted over the year from 30.5 to 25.3 percent, going back to the level of late 2011.

As of January 1, 2018 there were solely two RF subjects with the correlation of state debt to tax and non-tax revenues exceeds 100 percent – Kostroma region (115.2 percent), and Republic of Mordovia (236.9 percent). Meanwhile a year earlier there were seven such regions.

Despite a general positive dynamics of the regional state debt the picture across the federal districts differs significantly. If in North-Western and North-Caucasus federal districts the reduction of nominal volume of the state debt in 2018 were demonstrated by all regions, then in the Far-Eastern federal district there were only 50 percent of such regions.

The structure of state regional debt over the year stayed practically unchanged: budget loans still prevail, which share constituted by the year-end 42.6 percent falling relative to late 2017 by 1 percent (*Fig. 21*). The share of loans issued by the credit organizations remained at 28.8 percent, halting decline which procrastinated from late 2013, and the share of the state securities over the year moved up by 1.3 percent hitting 25.0 percent. Securities were the sole debt regional instrument which volume over the year increased in nominal terms.



Sources: Finance Ministry of Russia, own calculations.

Fig. 21. Structure of state debt of the RF subjects in 2008–2018